ST 02-9

Tax Type:

Sales Tax

Issue:

**Application of SOT on the Repair and Refurbishing of Aircraft** 

#### STATE OF ILLINOIS DEPARTMENT OF REVENUE OFFICE OF ADMINISTRATIVE HEARINGS

THE DEPARTMENT OF REVENUE OF THE STATE OF ILLINOIS	)	Docket No. IBT No.	99-ST-0000 0000-0000
v.		NTL No. IBT No. NTL Nos.	SF-19990000000000000000000000000000000000
"AVALON SOBOL, INC.",	)	John E. Whi	ite,
Taxpayer	)	Administrati	ive Law Judge

#### RECOMMENDATION FOR DISPOSITION

**Appearances:** 

Sheldon Migdal, Wildman, Harrold Allen & Dixon, appeared for "Avalon Sobol, Inc."; John Alshuler, Special Assistant Attorney General, appeared for the Illinois Department of Revenue.

Synopsis: This matter arose after "Avalon Sobol, Inc." ("Avalon" or "taxpayer") protested separate Notices of Tax Liability ("NTL's") the Illinois Department of Revenue ("Department") issued to it. The NTL's assessed Illinois Service Occupation Tax ("SOT") against taxpayer, and were issued following the Department's audit of taxpayer's business for the monthly periods beginning January 1, 1992 through and including December 31, 1994.

Prior to hearing, the parties agreed that the issue to be resolved is whether "Avalon's" cost price of tangible personal property it transferred to others incident to its sales of service was exempt from SOT, pursuant to § 3-45 of the Service Occupation Tax Act ("SOTA"). At hearing, the Department introduced certified copies of the NTL's and the Department's correction of taxpayer's returns, as well as the testimony of the auditor.

Taxpayer introduced a stipulation of facts and stipulated exhibits, and the testimony of a Department employee. After considering the evidence of record, I am making findings of fact and conclusions of law. I recommend that the issue be resolved in favor of the Department, but that taxpayer be given a credit for the amount of tax properly due and paid to other states regarding some of the transactions for which SOT was assessed here.

#### Findings of Fact:

- "Avalon" was incorporated under the laws of the State of Delaware on May 13, 1985. Stipulation of Facts ("Stip.") ¶ 1. Its corporate headquarters and commercial domicile were located in "Someplace", New Jersey. *Id.* In 1999, "Avalon" changed its name to "Hutsucker, Inc." *Id.*
- 2. During the period beginning January 1, 1992 through December 31, 1994 (the "audit period"), "Avalon" was a diversified technology, manufacturing, and service company that served customers worldwide with aerospace products and services, automotive products, chemicals, fibers, plastics, and advanced materials. Stip. ¶ 2. "Avalon" operated some 400 facilities with 86,000 employees in the United States and 40 other countries and territories. *Id*.
- 3. As part of its aerospace business, "Avalon" performed a variety of services for owners of business aircraft. Stip. ¶ 3. These services included: the complete disassembly, repair, reassembly, and functionality testing of aircraft engines; service and repair of aircraft airframes, avionics, and aircraft interiors; transient services such as oil and filter changes, and removal and replacement of accessories and components; and retrofits of business jet aircraft. *Id*.

- 4. A basic retrofit, described in "Avalon's" contracts as a "Modification" (*see* Stip. Exs. 8, 11, 14, 16, 18, 20, 23, 25, 32, 35, 37 (p. 1 and § 1.1 of each exhibit)), and referred to as such hereafter, involves the replacement of the original engines on the aircraft with new engines, and the installation of new pylons, nacelles, and associated wiring, plumbing, and cockpit instrumentation necessary to accommodate the new engines. Stip. ¶ 3; Stip. Exs. 8, 11, 14, 16, 18, 20, 23, 25, 32, 35 (Exhibit A, Section II to each modification agreement). A retrofit could also involve, at the customer's option, upgraded avionics, auxiliary power units, thrust reversers, and refurbishments to the interior of the aircraft. Stip. ¶ 3.
- 5. "Avalon" ordinarily sells to its customers all of the tangible personal property (hereinafter, "goods") it transfers to customers by installing such goods into or onto the customer's aircraft. Stip. Exs. 8, 11, 14, 16, 18, 20, 23, 25, 28 (p. 2, ¶ 5), 30 (p. 2, ¶ 5), 32, 35; but see Stip. Ex. 28, p. 1 § 1.2 ("The jumpseat will be upholstered with customer furnished fabric on the cushions and have leather trim. A new seal belt will be furnished and installed").
- 6. "Avalon" performed aircraft services in the United States at facilities in "Sandburg", Illinois (the ""Sandburg" hangar"), as well as in California, Texas, Georgia, and New York. Stip. ¶ 4.
- 7. When a customer hires "Avalon" to sell or otherwise transfer goods by installing them into or onto the customer's aircraft, it signs a written agreement that "Avalon" presents to it. *See* Stip. Exs. 8, 11, 14, 16, 18, 20, 23, 25, 28, 30, 32, 35, 37.

- 8. A separate division of "Avalon" manufactures the "ABCD" turbofan engines that are installed onto a customer's aircraft during a modification. Stip. Exs. 8, 11, 14, 16, 18, 20, 23, 25, 32, 35, 37 (§ 1.1 & Exhibit A § 2.1, of each exhibit) (all identifying the new engines to be installed as "... ["Avalon"] "ABCD" Turbofan Engine ..."); Stip. Ex. 46 (memo, dated 2/19/97, written by the Department's auditor), p. 3 (identifying the manufacturing unit as a separate division of "Avalon").
- 9. Each modification agreement has five separate sections, which have the following headings: Section 1, Subject Matter; Section 2, Purchase Price and Payment; Section 3, Delivery; Section 4, Installation Facilities; Section 5, Miscellaneous. Stip. Exs. 8, 11, 14, 16, 18, 20, 23, 25, 32, 35, 37. Sometimes, the heading for § 4 states, "Intentionally Deleted." *E.g.*, Stip. Exs. 14, 20.
- 10. Each modification agreement has at least one exhibit, which specifically describes, *inter alia*, the goods being purchased for installation on a customer's aircraft, the method of installation, and the quality standards "Avalon" will meet when installing such goods. Stip. Exs. 8, 11, 14, 16, 18, 20, 23, 25, 32, 35, 37 (Exhibit A thereto).

# Facts Regarding Pertinent Aspects of the FAA's Regulation of Persons Who Make Major Repairs and/or Alterations of Aircraft Within the United States

11. Persons who make major repairs and/or alterations of aircraft within the United States are certified and regulated by the Federal Aviation Administration ("FAA"). 49 U.S.C. §§ 40101(c) (General Safety Considerations), 40101(d) (Safety Considerations in Public Interest); 14 C.F.R. § 43.3 (Persons authorized to perform maintenance, preventive maintenance, rebuilding, and alterations).

- 12. Any person who makes a major repair and/or alteration of an aircraft within the United States is required to prepare a FAA Form 337 before the aircraft is returned to service. 14 C.F.R. §§ 43.5 (Approval for return to service after maintenance, preventive maintenance, rebuilding, or alteration); 43.7 (Persons authorized to approve aircraft, airframes, aircraft engines, propellers, appliances, or component parts for return to service after maintenance, preventive maintenance, rebuilding, or alteration); 43.9 (Content, form, and disposition of maintenance, preventive maintenance, rebuilding, and alteration records); *see also* FAA Form 337 (revised December 1988) (a copy of a FAA Form 337, and the current applicable Federal Aviation Regulations, are available on-line at the FAA website (http://www.faa.gov)).
- 13. FAA Form 337 has eight parts. *See* FAA Form 337 (revised December 1988). The first two parts identify, respectively, the aircraft and the owner of the aircraft to which a major repair or alteration has been made. Part 3 is reserved for FAA use. Part 4 identifies the unit parts of the aircraft, i.e., an airframe, powerplant (engine), propeller or appliance, to which an alteration or repair has been made. Part 6 identifies whether a repair or an alteration was made to any respective unit of an aircraft. Part 6 is a statement of conformity, in which an authorized person, be it a U.S. certified mechanic, a foreign certified mechanic, a certified repair station or a manufacturer, signs a certification that, "... the repair and/or alteration made to the unit(s) identified in item 4 above and described on the reverse or attachments hereto have been made in accordance with the requirements of Part 43 of the U.S. Federal Aviation Regulations and that the information furnished

herein is true and correct to the best of my knowledge." Part 7 is a section in which a FAA flight standards inspector, a manufacturer, a FAA designee, a repair station, a person approved by Transport Canada Airworthiness Group, or some other person signs the form to indicate whether, and on what date, "... the unit identified in item 4 was inspected in the manner prescribed by the Administrator of the Federal Aviation Administration and is [either] APPROVED [or] REJECTED [for return to service]." Finally, part 8 is a section that requires a description of the major repair or alteration made.

14. Consistent with the safety regulations imposed by the FAA on its business, each of "Avalon's" contracts identify the federal forms that must be completed before an aircraft being modified or serviced by it may be returned to service. Stip. Exs. 8, 11, 14, 16, 18, 20, 23, 25, 32, 35, 37 (§ 3.2 of each agreement); Stip. Ex. 28, p. 16; Stip. Ex. 30, p. 8.

## Facts Regarding "Avalon's" Agreement With "Psi Corp".

- 15. On or about July 15, 1992, "Psi Corporation" ("Psi") entered into a contract with "Avalon" for the modification of "Psi's" aircraft, a Falcon 20 bearing serial no. 463. Stip. ¶ 8; Stip. Ex. 8 (copy of agreement) (While the parties stipulate that the aircraft belongs to "Psi Corp.", the text of the agreement provides that the buyer of the modification is "Wharburton Leasing Inc." Stip. Ex. 8, p. 1).
- 16. Section 1.1 of that agreement states, in pertinent part, that:
  - "... ["Avalon"] agrees to sell to Buyer and Buyer agrees to purchase from ["Avalon"] an "ABCD" engine modification, more particularly described in Exhibit A, attached hereto and made a part hereof, and thrust reversers, (hereinafter referred to as "Modification"), upon the terms and conditions herein provided and in Exhibit A. Such Modification shall be performed on Buyer's Falcon

20, Series \_ Aircraft, Serial No. "123", Registration No. "N000A", (hereinafter referred to as "Aircraft").

Stip. Ex. 8, p. 1 § 1.1 (blank underlined spaces original).

### 17. Section 3.2 of the agreement states:

When the Modification is complete and the Aircraft is ready for delivery to Buyer, the Installation Facility shall notify Buyer and Buyer shall promptly thereafter inspect the Aircraft at the Installation Facility to determine its compliance with Exhibit A. The Modification will comply with Service Bulletin 731, and proof of compliance will be demonstrated by a FAA form 337 approved by a FAA Inspector ... and an entry into the Aircraft logbook. Such inspection, if requested by Buyer, may include an in-flight demonstration of the Aircraft, at Buyer's expense. Should inspection reveal any discrepancies in Modification, ["Avalon"] shall provide that they shall be corrected by the Installation Facility, at no expense to the Buyer. Buyer shall then be deemed to have accepted the Modification. Delivery of the Aircraft and Modification to Buyer may, by mutual agreement of the parties hereto, be at a later time and different location, provided that the Buyer takes delivery no later than seven (7) days after accepting the modification pursuant to the terms hereof. Should the Buyer fail to do so, delivery of the Aircraft and Modification shall be deemed to have taken place when Buyer was deemed to have accepted the Modification.

Stip. Ex. 8, pp. 3-4 § 3.2 (emphasis added).

- 18. Taxpayer performed the modification, and installed the new engines and other goods it transferred to "Psi" as an incident to providing such services, at the "Sandburg" hangar. Stip. ¶ 8; Stip. Ex. 8, p. 5 § 5.1. After "Avalon" completed the modification, "Psi" inspected and accepted it pursuant to § 3.2 of the agreement. Stip. ¶ 8; Stip. Ex. 8, pp. 3-4 § 3.2.
- 19. Thereafter, on December 16, 1992, "Avalon" redelivered possession of the aircraft to "Psi" by flying it from the "Sandburg" hangar to Wilmington, Delaware, as agreed to by the parties. Stip. ¶ 9. There, "Psi" signed a document

- titled, Aircraft Final Acceptance And Delivery Agreement (hereinafter, "delivery receipt"). Stip. ¶ 9; Stip. Ex. 9 (copy of delivery receipt).
- 20. Before taxpayer flew the aircraft back to "Psi", five (5) minor open items, or "squawks" (minor deficiencies which did not affect the airworthiness of the aircraft) had been identified with respect to the aircraft. Stip. ¶ 9a; Stip. Ex. 8, p. 3 § 3.2 ("\*\*\* Should the inspection reveal any discrepancies, ["Avalon"] shall provide that they shall be corrected by the Installation Facility, at no expense to the Buyer. \*\*\*"); Stip. Ex. 10 (copy of squawk list prepared by taxpayer). After "Psi" was made aware of those squawks, it asked that taxpayer fly the aircraft back to it before "Avalon" corrected them, and agreed that they would be corrected as warranty repairs, at a future date. Stip. ¶ 9a; Stip. Ex. 8, p. 3 § 3.2.
- 21. After "Avalon" redelivered possession of the aircraft to "Psi", "Psi" had the aircraft flown back to the "Sandburg" hangar on the dates, and for the purposes, indicated below. Stip. ¶ 9b.

Arrival	Departure	Type of Service Performed
3/30/93	4/1/93	Routine service unrelated to retrofit contract
10/26/93	11/4/93	Routine service unrelated to retrofit contract
2/15/94	3/2/94	Routine service unrelated to retrofit contract; and warranty services under retrofit contract
8/3/94	8/15/94	Routine service unrelated to retrofit contract

Stip. ¶ 9b. All of the work that was not warranty-related was separately charged and paid for by "Psi". *Id*.

## Facts Regarding "Avalon's" Agreement With "Lexicon Corp."

Four of the documents referred to in this recommendation as delivery receipts are titled, "Aircraft Final Acceptance and Delivery Agreement" (*see* Stip. Exs. 9, 12, 15, 38), and the rest are titled, "Aircraft Final Acceptance and Delivery." Stip. Exs. 17, 19, 21, 24, 26, 29, 31, 33, 36.

- 22. On or about June 23, 1992, "Lexicon Corporation" ("Lexicon") entered into a contract with "Avalon" for the modification of "Lexicon's" aircraft, a Falcon 20 bearing serial no. "111". Stip. ¶ 10; Stip. Ex. 11 (copy of agreement).
- 23. Section 1.1 of that agreement states, in pertinent part:

"... ["Avalon"] agrees to sell to Buyer and Buyer agrees to purchase from ["Avalon"] an "ABCD" engine modification, more particularly described in Exhibit A, attached hereto and made a part hereof, and thrust reversers, (hereinafter referred to as "Modification"), upon the terms and conditions herein provided and in Exhibit A. Such Modification shall be performed on Buyer's Falcon 20, Series \_ Aircraft, Serial No. "111", Registration No. \_ (hereinafter referred to as "Aircraft").

Stip. Ex. 11, p. 1 § 1.1.

## 24. Section 3.2 of the agreement states:

When the Modification is complete and the Aircraft is ready for delivery to Buyer, the Installation Facility shall notify Buyer and Buyer shall promptly thereafter inspect the Aircraft at the Installation Facility to determine its compliance with Exhibit A. The Modification will comply with Service Bulletin 731, and proof of compliance will be demonstrated by a FAA form 337 approved by a FAA Inspector ... and an entry into the Aircraft logbook. Such inspection will include an in-flight demonstration of the Aircraft, at Buyer's expense. Should such inspection reveal any discrepancies in the Modification, ["Avalon"] shall provide that they shall be corrected by the Installation Facility, at no expense to the Buyer. Buyer shall then be deemed to have accepted the Modification. Delivery of the Aircraft and Modification to Buyer may, by mutual agreement of the parties hereto, be at a later time and different location, provided that the Buyer takes delivery no later than seven (7) days after accepting the modification pursuant to the terms hereof. Should the Buver fail to do so, delivery of the Aircraft and Modification shall be deemed to have taken place when Buyer was deemed to have accepted the Modification.

Stip. Ex. 11, pp. 3-4 § 3.2 (emphasis added).

- 25. Taxpayer performed the modification, and installed the new engines and other goods it transferred to "Lexicon" as an incident to providing such services, at the "Sandburg" hangar. Stip. ¶ 10; Stip. Ex. 11, p. 4 § 4.1. After "Avalon" completed the modification, "Lexicon" inspected and accepted it pursuant to § 3.2 of the agreement. Stip. ¶ 10; Stip. Ex. 11, p. 3 § 3.2.
- Thereafter, on August 4, 1993, "Avalon" redelivered possession of the aircraft to "Lexicon" by flying it from the "Sandburg" hangar to Wilmington, Delaware, as agreed to by the parties. Stip. ¶ 10; Stip. Ex. 11, p. 3 § 3.2; Stip. Ex. 12 (copy of delivery receipt). There, "Lexicon" signed a delivery receipt for the aircraft. Stip. ¶ 10; Stip. Ex. 12.
- 27. Before "Avalon" flew the aircraft back to "Lexicon", nineteen (19) squawks were identified with respect to the aircraft, and "Lexicon" was made aware of those squawks. *See* Stip. 10a; Stip. Ex. 11, p. 3 § 3.2; Stip. Ex. 13 (copy of squawk list). "Lexicon" asked that "Avalon" fly the aircraft back to it before correcting the squawks, and it agreed that "Avalon" would correct them as warranty repairs, at a future date. Stip. ¶ 10a.
- 28. After "Avalon" redelivered possession of the aircraft to "Lexicon", "Lexicon" had the aircraft flown back to the "Sandburg" hangar on the dates, and for the purposes, indicated below. Stip. ¶ 10b.

Arrival	Departure	Type of Service Performed
8/5/93	8/30/93	Routine service unrelated to retrofit contract; and warranty services under retrofit contract
9/8/93	9/13/93	Warranty services under retrofit contract
10/6/93	10/14/93	Warranty services under retrofit contract
12/13/93	12/22/93	Warranty services under retrofit contract
7/20/94	7/26/94	Warranty services under retrofit contract
7/28/94	8/3/94	Warranty services under retrofit contract
9/7/94	9/28/94	Routine service unrelated to retrofit contract; and warranty services under retrofit contract
11/21/94	11/23/94	Warranty services under retrofit contract
12/19/94	12/22/94	Routine service unrelated to retrofit contract; and warranty services under retrofit contract

Stip. ¶ 10a. All work performed on the aircraft that was not warranty-related was separately charged and paid for by "Lexicon". *Id*.

#### Facts Regarding "Avalon's Agreement With "Moravian Avionics, Inc."

- 29. On or about August 19, 1992, "Moravian Avionics, Inc." ("Moravian") entered into a contract with "Avalon" for the modification of "Moravian's" aircraft, a Falcon 20 bearing serial no. "222". Stip. ¶ 11; Stip. Ex. 14 (dated on p. 1 of Exhibit B to modification agreement).
- 30. Section 1.1 of that agreement states, in pertinent part:
  - "... ["Avalon"] agrees to sell to Buyer and Buyer agrees to ["Avalon"] "ABCD" purchase from an engine modification, more particularly described in Exhibit A, attached hereto and made a part hereof, thrust reversers, (hereinafter referred to as "Modification"), and other work defined in Exhibit B attached hereto and made a part hereof (hereinafter described as "Work"), upon the terms and conditions herein provided and in Exhibit A. Modification and Work shall be performed on Buyer's Falcon 20, Series D Aircraft, Serial No. "222", Registration No. "N111Z" (hereinafter referred to as "Aircraft").

Stip. Ex. 14, p. 1 § 1.1.

#### 31. Section 3.2 of that agreement states:

When the Modification and Work is complete and the Aircraft is ready for delivery to Buyer, ["Avalon"] shall notify Buyer and Buyer shall promptly thereafter inspect the Aircraft at the Installation Facility to determine its

compliance with Exhibit A and Exhibit B. Modification will comply with Service Bulletin 731, and proof of compliance will be demonstrated by a FAA form 337 approved by a FAA Inspector and an entry into the Aircraft logbook. Such inspection, if requested by Buyer, may include an in-flight demonstration of the Aircraft, at Buyer's expense (exclusive of ["Avalon"] personnel expense). Should such inspection reveal any discrepancies in the Modification and Work, ["Avalon"] shall correct same, at no expense to the Buyer. Buyer shall then be deemed to have accepted the Modification and Work. Delivery of the Aircraft and Modification and Work to Buyer may, by mutual agreement of the parties hereto, be at a later time and different location, provided that the Buyer takes delivery no later than seven (7) days after accepting the modification pursuant to the terms hereof. Should the Buyer fail to do so, delivery of the Aircraft and Modification shall be deemed to have taken place when Buyer was deemed to have accepted the Modification and Work.

Stip. Ex. 14, p. 3 § 3.2 (emphasis added).

- 32. "Avalon" performed the modification, and installed the new engines and other goods it transferred to "Moravian" as an incident to providing such services, at the "Sandburg" hangar. Stip. ¶ 11. After "Avalon" completed the modification, "Moravian" inspected and accepted it pursuant to § 3.2 of the agreement. Stip. ¶ 11; Stip Ex. 14, p. 3 § 3.2.
- 33. Thereafter, on February 27, 1993, "Avalon" redelivered possession of the aircraft to "Moravian" by flying it from the "Sandburg" hangar to Wilmington, Delaware, as agreed to by the parties. Stip ¶ 11; Stip Ex. 14, p. 3 § 3.2; Stip Ex. 15 (copy of delivery receipt). There, "Moravian" signed a delivery receipt for the aircraft. Stip. ¶ 11; Stip. Ex. 15 (copy of delivery receipt).

34. After "Avalon" redelivered possession of the aircraft to "Moravian", "Moravian" had it flown back to the "Sandburg" hangar on the date, and for the purpose, indicated below. Stip. ¶ 11a.

Arrival	Departure	Type of Service Performed
8/2/93	8/11/93	Routine service unrelated to retrofit contract; and warranty services under retrofit contract

Stip. ¶ 11b. All work performed on the aircraft that was not warranty-related was separately charged and paid for by "Moravian". Stip. ¶ 11a.

## Facts Regarding "Avalon's" Agreement With "Adirondack Oil, Inc."

- 35. On or about December 30, 1992, "Adirondack Oil, Inc." ("Adirondack") entered into a contract with "Avalon" for the modification of "Adirondack's" aircraft, a Falcon 20 bearing serial no. "333". Stip. ¶ 12.
- 36. Section 1.1 of that agreement states, in pertinent part:

"... ["Avalon"] agrees to sell to Buyer and Buyer agrees to purchase from ["Avalon"] an "ABCD" engine modification and "XYZ" Thrust Reverser System as more particularly described in Exhibit A, attached hereto and made a part hereof, (hereinafter referred to as "Modification"), upon the terms and conditions herein provided and in Exhibit A. Such Modification shall be performed on Buyer's Falcon 20, Series F Aircraft, Serial Number "333", Registration No. "N5572B" (hereinafter referred to as "Aircraft").

Stip. Ex. 16, p. 1 § 1.1.

37. Section 3.2 of that agreement states:

When the Modification and Work is complete and the Aircraft is ready for delivery to Buyer, the Installation Facility shall notify Buyer and Buyer shall promptly thereafter inspect the Aircraft at the Installation Facility to determine its compliance with Exhibit A. The Modification will comply with Service Bulletin 731, and proof of compliance will be demonstrated by a FAA Form 337 approved by a FAA Inspector and an entry into the Aircraft logbook. Such inspection, if requested by Buyer,

may include an in-flight demonstration of the Aircraft, at Buyer's expense. Should such inspection reveal any discrepancies in the Modification, ["Avalon"] shall provide that they shall be corrected by the Installation Facility, at no expense to the Buyer, and Buyer shall be allowed to have a representative agent present during the correcting of such discrepancies and to inspect all such corrections. After all such discrepancies have been fully corrected, Buyer shall be deemed to have accepted the Modification. Delivery of the Aircraft and Modification to Buyer may, by mutual agreement of the parties hereto, be at a later time (the date upon which Buyer takes delivery of the Aircraft is referred to herein as the "Delivery Date"), and different location, provided that the Buyer takes delivery no later than seven (7) days after accepting the modification pursuant to the terms hereof. Should the Buyer fail to do so, delivery of the Aircraft and Modification shall be deemed to have taken place at the end of such seven (7) day period.

Stip. Ex. 16, p. 3 § 3.2 (emphasis added).

- 38. "Avalon" performed the modification, and installed the new engines and other goods it transferred to "Adirondack" as an incident to providing such services, at the "Sandburg" hangar. Stip. ¶ 12. After "Avalon" completed the modification, "Adirondack" inspected and accepted it pursuant to § 3.2 of the agreement. Stip. ¶ 12; Stip. Ex. 16, p. 3 § 3.2.
- 39. Thereafter, August 4, 1993, "Avalon" redelivered possession of the aircraft to "Adirondack" by flying it from the "Sandburg" hangar to Wilmington, Delaware, as agreed to by the parties. Stip. ¶ 12; Stip. Ex. 17 (copy of delivery receipt). There, "Adirondack" signed a delivery receipt for the aircraft. Stip. Ex. 17.
- 40. After "Avalon" redelivered possession of the aircraft to "Adirondack", "Adirondack" had it flown back to the "Sandburg" hangar on the dates, and for the purposes, indicated below. Stip. ¶ 12a. All work performed on the aircraft that

was not warranty-related was separately charged and paid for by "Adirondack".

Arrival	Departure	Type of Service Performed
4/15/94	4/22/94	Warranty services under retrofit contract
8/17/94	8/19/94	Routine service unrelated to retrofit contract; and warranty services under retrofit contract

Stip. ¶ 12a.

Id.

## Facts Regarding "Avalon's" Agreement With "Marzipan Aeronautics"

- 41. On or about August 19, 1993, "Marzipan Aeronautics" ("Marzipan") entered into a contract with "Avalon" for the modification of "Marzipan's" aircraft, a Falcon 20 bearing serial no. "444". Stip. ¶ 13; but see Stip. Ex. 18, p. 1 (the written agreement that the parties stipulate is between "Marzipan Aeronautics" and "Avalon" provides that the Buyer of the Modification is "Brothers Karamozov, Inc.").
- 42. Section 1.1 of that agreement states, in pertinent part:

"... ["Avalon"] agrees to sell to Buyer and Buyer agrees to purchase from ["Avalon"] an "ABCD" engine modification, more particularly described in Exhibit A, attached hereto and made a part hereof, (hereinafter referred to as "Modification"), upon the terms and conditions herein provided and in Exhibit A. Such Modification shall be performed on Buyer's Falcon 20, Series F Aircraft, Serial Number "444", Registration No. \_, (hereinafter referred to as "Aircraft").

Stip. Ex. 18, p. 1 § 1.1.

43. Section 3.2 of that agreement states:

When the Modification is complete and the Aircraft is ready for delivery to Buyer, ["Avalon"] shall notify Buyer and Buyer shall promptly thereafter inspect the Aircraft at the Installation Facility to determine its compliance with Exhibit A. The Modification will comply with Service Bulletin 731, and proof of compliance will be demonstrated

by a FAA Form 337 approved by a FAA Inspector and an entry into the Aircraft logbook. Such inspection, if requested by Buyer, may include an in-flight demonstration of the Aircraft, at Buyer's expense. Should such inspection reveal any discrepancies in the Modification, ["Avalon"] shall provide that they shall be corrected at no expense to the Buyer. Buyer shall then be deemed to have accepted the Modification. Delivery of the Aircraft and Modification to Buyer may, by mutual agreement of the parties hereto, be at a later time and different location, provided that the Buyer takes delivery no later than seven (7) days after accepting the modification pursuant to the terms hereof. Should the Buyer fail to do so, delivery of the Aircraft and Modification shall be deemed to have taken place when the Buyer was deemed to have accepted the Modification.

Stip. Ex. 18, p. 3 § 3.2 (emphasis added).

- 44. "Avalon" performed the modification, and installed the new engines and other goods it transferred to "Marzipan" as an incident to providing such services, at the "Sandburg" hangar. Stip. ¶ 13. After "Avalon" completed the modification, "Marzipan" inspected and accepted it pursuant to § 3.2 of the agreement. Stip. ¶ 13; Stip. Ex. 18, p. 3 § 3.2.
- 45. Thereafter, on December 21, 1993, "Avalon" redelivered possession of the aircraft to "Marzipan" by flying it from the "Sandburg" hangar to Wilmington, Delaware, as agreed to by the parties. Stip. ¶ 13; Stip. Ex. 19 (copy of delivery receipt). There, "Adirondack" signed a delivery receipt for the aircraft. Stip. Ex. 19.
- 46. When "Avalon" flew the aircraft back to "Marzipan", the "N" identification numbers and the windshield embellisher paint on the aircraft needed to be repainted. Stip. ¶ 13a. These squawks first became apparent after the aircraft arrived in Wilmington, and were noted on the delivery receipt. *Id*.

47. After "Avalon" redelivered possession of the aircraft to "Marzipan", "Marzipan" had it flown back to the "Sandburg" hangar on the dates, and for the purposes, indicated below. Stip. 13b.

Arrival	Departure	Type of Service Performed
10/19/94	10/28/94	Routine service unrelated to retrofit contract
12/12/94	12/28/94	Routine service unrelated to retrofit contract; and warranty services under retrofit contract

Stip. ¶ 13b. All work performed on the aircraft that was not warranty-related was separately charged and paid for by "Marzipan". *Id*.

## Facts Regarding "Avalon's" Agreement With "Laconic Insurance Co."

- 48. On or about March 1, 1993, "Laconic Insurance Company" ("Laconic") entered into a contract with "Avalon" for the modification of "Laconic's aircraft, a Falcon 20 bearing serial no. "555". Stip. ¶ 14; Stip. Ex. 20.
- 49. Section 1.1 of that agreement states, in pertinent part:
  - "... ["Avalon"] hereby agrees to sell to Buyer and Buyer agrees to purchase from ["Avalon"] an "ABCD" engine modification, more particularly described in Exhibit A, attached hereto and made a part hereof, (hereinafter referred to as "Modification"), upon the terms and conditions herein provided and in Exhibit A. Such Modification shall be performed on Buyer's Falcon 20, Series F Aircraft, Serial Number "555", Registration No. "N300DD", (hereinafter referred to as "Aircraft").

Stip. Ex. 20, p. 1 § 1.1.

50. Section 3.2 of that agreement states:

When the Modification is complete and the Aircraft is ready for delivery to Buyer, ["Avalon"] shall notify Buyer and Buyer shall promptly thereafter inspect the Aircraft at the Installation Facility to determine its compliance with Exhibit A. The Modification will comply with Service Bulletin 731, and proof of compliance will be demonstrated by a FAA Form 337 approved by a FAA Inspector and an entry into the Aircraft logbook. Such inspection, if

requested by Buyer, may include an in-flight demonstration of the Aircraft, at Buyer's expense. Should such inspection reveal any discrepancies in the Modification, ["Avalon"] shall provide correct the same at no expense to the Buyer. After such discrepancies are corrected by ["Avalon"], Buyer shall have the right to re-inspect the Aircraft, including another in-flight demonstration, at Buyer's expense, provided that Buyer shall be satisfied that all discrepancies have been corrected, then Buyer shall then be deemed to have accepted the Modification. ["Avalon"] shall provide its flight crew to deliver the Aircraft and Modification to Buyer in the State of New Hampshire. Delivery of the Aircraft and Modification to Buyer may, by mutual agreement of the parties hereto, be at a later time and different location, provided that the Buyer takes delivery no later than seven (7) days after accepting the modification pursuant to the terms hereof.

Stip. Ex. 20, p. 3 § 3.2 (emphasis added).

- 51. "Avalon" performed the modification, and installed the new engines and other goods it transferred to "Laconic" as an incident to providing such services, at the "Sandburg" hangar. Stip. ¶ 14. After "Avalon" completed the modification, "Laconic" inspected and accepted it pursuant to § 3.2 of the agreement. Stip. ¶ 14; Stip. Ex. 20, p. 3 § 3.2.
- Thereafter, on September 4, 1993, "Avalon" redelivered possession of the aircraft to "Laconic" by flying it from the "Sandburg" hangar to Bedford, Massachusetts (Stip. ¶ 14; Stip. Ex. 21), instead of to New Hampshire, as originally contemplated by the parties. Stip. ¶ 14; Stip. Ex. 20, p. 3 § 3.2; Stip. Ex. 21 (copy of delivery receipt). There, "Adirondack" signed a delivery receipt for the aircraft. Stip. Ex. 21.
- 53. "Avalon" charged and collected Massachusetts sales tax in the amount of \$107,500 from "Laconic" on the sale of the goods sold and incorporated into the

- retrofit. Stip. ¶ 14a. "Avalon" remitted this tax to the Commonwealth of Massachusetts. *Id.*; Stip. Ex. 22 (copy of "Avalon's" final invoice to "Laconic").
- 54. After "Avalon" redelivered possession of the aircraft to "Laconic", "Laconic" had it flown back to the "Sandburg" hangar on the dates, and for the purposes, indicated below. Stip. ¶ 14b.

Arrival	Departure	Type of Service Performed
9/8/93	9/13/93	Warranty services under retrofit contract
12/3/93	12/22/93	Routine service unrelated to retrofit contract; and warranty services under retrofit contract

Stip. ¶ 14b. All work performed on the aircraft that was not warranty-related was separately charged and paid for by "Laconic". *Id*.

## Facts Regarding "Avalon's" Agreement With "Adirondack" Oil, Inc.

- On or about October 23, 1993, "Adirondack" Oil, Inc. (""Adirondack"") entered into a contract with "Avalon" for the modification of a second "Adirondack" aircraft, a Falcon 20 bearing serial no. "661". Stip. ¶ 15; Stip. Ex. 23.
- 56. Section 1.1 of that agreement states, in pertinent part:
  - "... ["Avalon"] agrees to sell to Buyer and Buyer agrees to purchase from ["Avalon"] an "ABCD" engine modification, more particularly described in Exhibit A, attached hereto and made a part hereof, and thrust reversers, (hereinafter referred to as "Modification"), upon the terms and conditions herein provided and in Exhibit A. Such Modification shall be performed on Buyer's Falcon 20, Series F Aircraft, Serial Number "661", Registration No. "N00IOU", (hereinafter referred to as "Aircraft").

Stip. Ex. 23, p. 1 § 1.1.

57. Section 3.2 of that agreement states:

When the Modification is complete and the Aircraft is ready for delivery to Buyer, ["Avalon"] shall notify Buyer and Buyer shall promptly thereafter inspect the Aircraft at the Installation Facility to determine its compliance with Exhibit A. The Modification will comply with Service

Bulletin 731, and proof of compliance will be demonstrated by a FAA Form 337 approved by a FAA Inspector and an entry into the Aircraft logbook. Such inspection, if requested by Buyer, may include an in-flight demonstration of the Aircraft, at Buyer's expense. Should such inspection reveal any discrepancies in the Modification, ["Avalon"] shall provide that they shall be corrected by the Installation Facility, at no expense to the Buyer, and Buyer shall be allowed to have a representative agent present during the correcting of such discrepancies and to inspect such corrections. After all such discrepancies have been fully corrected, Buyer shall be deemed to have accepted the Modification. Delivery of the Aircraft and Modification to Buyer may, by mutual agreement of the parties hereto, be at a later time (the date upon which Buyer takes delivery of the Aircraft is referred to herein as the "Delivery Date"), and different location, provided that the Buyer takes delivery no later than seven (7) days after accepting the Modification pursuant to the terms hereof. Should the Buyer fail to do so, delivery of the Aircraft and Modification shall be deemed to have taken place at the end of such seven (7) day period.

Stip. Ex. 23, pp. 3-4 § 3.2 (emphasis added).

- 58. "Avalon" performed the modification, and installed the new engines and other goods it transferred to "Adirondack" as an incident to providing such services, at the "Sandburg" hangar. Stip. ¶ 15. After "Avalon" completed the modification, "Adirondack" inspected and accepted it pursuant to § 3.2 of the agreement. Stip. ¶ 15; Stip. Ex. 23, pp. 3-4 § 3.2.
- 59. Thereafter, on April 1, 1994, "Avalon" redelivered possession of the aircraft to "Adirondack" by flying it from the "Sandburg" hangar to Wilmington, Delaware, as agreed to by the parties. Stip. ¶ 15; Stip. Ex. 24 (copy of delivery receipt). There, "Adirondack" signed a delivery receipt for the aircraft. Stip. Ex. 24.

60. After "Avalon" redelivered possession of the aircraft to "Adirondack", "Adirondack" had it flown back to the "Sandburg" hangar on the dates, and for the purposes, indicated below. Stip. ¶ 15a.

Arrival	Departure	Type of Service Performed
4/6/94	4/15/94	Routine service unrelated to retrofit contract; and warranty services under retrofit contract
10/27/94	11/2/94	Routine service unrelated to retrofit contract

Stip. ¶ 15a. All work performed on the aircraft that was not warranty-related was separately charged and paid for by "Adirondack". *Id*.

## Facts Regarding "Avalon's" Agreement With "Iceberg Insulation Corp."

- 61. On or about February 11, 1994, "Iceberg Insulation Corporation ("Iceberg") entered into a contract with "Avalon" for the retrofit of "Iceberg's" aircraft, a Falcon 20 bearing serial no. "777". Stip. ¶ 16; Stip. ¶ 25.
- 62. Section 1.1 of that agreement states, in pertinent part:

... "Avalon" hereby agrees to sell to Buyer and Buyer agrees to purchase from "Avalon" an "ABCD" engine modification, more particularly described in Exhibit A and such improvements as are more particularly described on Exhibit B, attached hereto and made a part hereof, (hereinafter referred to as "Modification"), upon the terms and conditions herein provided and in Exhibits A and B. Such Modification shall be performed on Buyer's Falcon 20, Series F Aircraft, Serial Number "777", Registration No. "N123456", (hereinafter referred to as "Aircraft").

Stip. Ex. 25, p. 1 § 1.1.

63. Section 3.2 of that agreement states:

When the Modification is complete and the Aircraft is ready for delivery to Buyer, ["Avalon"] shall notify Buyer and Buyer shall promptly thereafter inspect the Aircraft at the Installation Facility to determine its compliance with Exhibits A and B. The Modification will comply with Service Bulletin 731, and proof of compliance will be demonstrated by a FAA Form 337 approved by a FAA

Inspection, if requested by Buyer, may include an in-flight demonstration of the Aircraft, at Buyer's expense. Should such inspection reveal any discrepancies in the Modification, "Avalon" shall provide that they shall be corrected by the Installation Facility, at no expense to the Buyer. Buyer shall accept the Modification after it has determined that the Aircraft complies with Exhibits A and B. Delivery of the Aircraft and Modification to Buyer may, by mutual agreement of the parties hereto, be at a later time and different location, provided that the Buyer takes delivery no later than seven (7) days after accepting the Modification pursuant to the terms hereof.

Stip. Ex. 25, p. 3 § 3.2 (emphasis added).

- 64. "Avalon" performed the modification, and installed the new engines and other goods it transferred to "Iceberg" as an incident to providing such services, at the "Sandburg" hangar. Stip. ¶ 16. After "Avalon" completed the modification, "Iceberg" inspected and accepted it pursuant to § 3.2 of the agreement. Stip. ¶ 16; Stip. Ex. 25, p. 3 § 3.2.
- 65. Thereafter, on June 17, 1994, "Avalon" redelivered possession of the aircraft to "Iceberg" by flying it from the "Sandburg" hangar to Indianapolis, Indiana, as agreed to by the parties. Stip. ¶ 16; Stip. Ex. 26 (copy of delivery receipt). There, "Iceberg" signed a delivery receipt for the aircraft. Stip. Ex. 26.
- "Avalon" charged and collected Indiana sales tax in the amount of \$105,000 from "Iceberg" on the sale of the goods sold and incorporated into the retrofit. Stip. ¶

  16a. "Avalon" remitted this tax to the State of Indiana. *Id.*; Stip. Ex. 27.
- 67. After "Avalon" redelivered possession of the aircraft on June 17, 1994, "Iceberg" had it flown back to the "Sandburg" hangar on the date, and for the purpose, indicated below. Stip. ¶ 16b.

Arrival	Departure	Type of Service Performed
12/18/94	1/10/95	Routine service unrelated to retrofit contract; and warranty services under retrofit contract

Stip. ¶ 16b. All work performed on the aircraft that was not warranty-related was separately charged and paid for by "Iceberg". *Id*.

## Facts Regarding "Avalon's" Agreement With "Aeronautic Administration Co."

- 68. On or about January 20, 1994, "Aeronautic Administration Company" ("Aeronautic") entered into a contract with "Avalon" for the purchase and installation of new avionics equipment and for interior modifications for "Aeronautic's" aircraft, a Jetstar bearing serial no. "888". Stip ¶ 17; Stip. Ex. 28.
- 69. "Avalon" performed the agreed upon installation and work, and installed the goods it transferred to "Aeronautic" as an incident to providing such services, at the "Sandburg" hangar. Stip. ¶ 17; Stip. Ex. 28, p. 2 ¶ 1.
- 70. Paragraph 10 of the agreement, titled, "Flights By ["Avalon"]", states:

This Agreement does not cover delivery flights of Customer's aircraft nor any other flights of Customer's aircraft. In the event that Customer desires ["Avalon"] to perform such service, they will be rendered under a separate Agreement which will require appropriate insurance and indemnification protection of ["Avalon"] by Customer before the commencement of such flight.

Stip. Ex. 28, p. 2 ¶ 10.

71. Under the heading "Avionics General", the agreement stated:

Equipment installation and interconnection will be accomplished in accordance with applicable manufacturer's recommendations and in accordance with FAA requirements. S.T.C.'s or 337's will be provided as required. \*\*\*

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Upon completion of all installation work, the aircraft will be given a preflight inspection and a complete system functional check.

A flight check is requested to ensure all avionics systems are performing to manufacturer's specifications. Flight cost, pilot, fuel, etc. is the responsibility of the customer.

Stip. Ex. 28, p. 16.

- After all of the installation work called for by the agreement was completed, and after the flight check called for by the agreement, "Aeronautic" accepted the alteration, and agreed to have "Avalon" redeliver possession of the aircraft by flying it from the "Sandburg" hangar. Stip. Ex. 28, pp. 2 (¶ 10), 16.
- 73. Thereafter, on April 7, 1994, "Avalon" redelivered possession of the aircraft to "Aeronautic" by flying it to Wilmington, Delaware, as agreed to by the parties. Stip. ¶ 17; Stip. Ex. 28, pp. 2 (¶ 10), 16; Stip. Ex. 29 (copy of delivery receipt). There, "Aeronautic" signed a delivery receipt for the aircraft. Stip. ¶ 17; Stip. Ex. 29.
- 74. After "Avalon" redelivered possession of the aircraft to "Aeronautic", "Aeronautic" had the aircraft flown back to the "Sandburg" hangar on the dates, and for the purposes, indicated below. Stip. ¶ 17a.

Arrival	Departure	Type of Service Performed
8/8/94	8/18/94	Routine service unrelated to contract
12/22/94	12/28/94	Routine service unrelated to contract

Stip. ¶ 17a. All work performed on the aircraft that was not warranty-related was separately charged and paid for by "Aeronautic". *Id*.

#### Facts Regarding "Avalon's" Agreement With "Industrial Inspiration, Inc."

75. On or about January 26, 1994, "Industrial Inspiration, Inc." ("Industrial") entered into a contract with "Avalon" for the purchase and installation of new avionics

equipment for, and for interior modifications to, "Industrial's" aircraft, a Falcon 900 bearing serial no. "999". Stip. ¶ 18; Stip. Ex. 30.

76. Paragraph 10 of the agreement, titled, "Flights By ["Avalon"]", states:

This Agreement does not cover delivery flights of Customer's aircraft nor any other flights of Customer's aircraft. In the event that Customer desires ["Avalon"] to perform such service, they will be rendered under a separate Agreement which will require appropriate insurance and indemnification protection of ["Avalon"] by Customer before the commencement of such flight.

Stip. Ex. 30, p. 2 ¶ 10.

77. Under the heading "General", the agreement provides:

Equipment installation and interconnection will be accomplished in accordance with applicable manufacturer's recommendations and in accordance with FAA requirements. [R]equired S.T.C.'s, 8110's and or 337's will be provided as required. \*\*\*

\*\*\*

Upon completion of all modification work, the aircraft will be given a preflight inspection and a complete system functional check.

A flight check is required to confirm the system is performing to manufacturer's specifications. Flight cost, pilot, fuel, etc. is the responsibility of the customer.

Stip. Ex. 30, pp. 7-8.

- 78. "Avalon" performed the agreed upon installation and work, and installed the goods it transferred to "Industrial" as an incident to providing such services, at the "Sandburg" hangar. Stip. ¶ 18; Stip. Ex. 30, p. 2 (¶ 1).
- After all of the installation work called for by the agreement was completed, and after the flight check called for by the agreement, "Industrial" accepted the alteration, and agreed to have "Avalon" redeliver possession of the aircraft by flying it from the "Sandburg" hangar. Stip. ¶ 18; Stip. Ex. 28, pp. 2 (¶ 10), 16.

80. Thereafter, on May 9, 1994, "Avalon" redelivered possession of the aircraft to "Industrial" by flying it to Portland, Oregon, as agreed to by the parties. Stip. ¶ 18; Stip. Ex. 30, pp. 2 ¶ 10, 7-8; Stip. Ex. 31 (copy of delivery receipt). There, "Industrial" signed a delivery receipt for the aircraft. Stip. ¶ 18; Stip. Ex. 31.

### Facts Regarding "Avalon's" Agreement With "Barclay Management, Inc."

- 81. On or about April 19, 1994, "Barclay Management, Inc." ("Barclay") entered into a contract with "Avalon" for the modification of "Barclay's aircraft, a Falcon 20 bearing serial no. "1111". Stip. ¶ 19; Stip. Ex. 32.
- 82. Section 1.1 of that agreement states, in pertinent part, that:

... "Avalon" hereby agrees to sell to Buyer and Buyer agrees to purchase from "Avalon" an "ABCD" engine modification, more particularly described in Exhibit A attached hereto and made a part hereof, and Thrust Reversers (hereinafter collectively referred to as "Modification"), upon the terms and conditions herein provided and in Exhibit A. Such Modification shall be performed on Buyer's Falcon 20, Series F Aircraft, Serial Number 319, Registration No. "N1456B", (hereinafter referred to as "Aircraft").

Stip. Ex. 32, p. 1 § 1.1.

83. Section 3.2 of the agreement states:

When the Modification is complete and the Aircraft is ready for delivery to Buyer, the Installation Facility shall notify Buyer and Buyer shall promptly thereafter inspect the Aircraft at the Installation Facility to determine its compliance with Exhibit A. The Modification will comply with Service Bulletin 731, and proof of compliance will be demonstrated by a FAA form 337 approved by a FAA Inspector ... and an entry into the Aircraft logbook. Such inspection, if requested by Buyer, may include an in-flight demonstration of the Aircraft, at Buyer's expense. Should such inspection reveal any discrepancies in the Modification, "Avalon" shall provide that they shall be corrected by the Installation Facility, at no expense to the Buyer. Buyer shall accept the Modification after it has

determined that the Aircraft complies with Exhibit A. Delivery of the Aircraft and Modification to Buyer may, by mutual agreement of the parties hereto, be at a later time and different location, provided that the Buyer takes delivery no later than seven (7) days after accepting the modification pursuant to the terms hereof.

Stip. Ex. 32, pp. 3 § 3.2 (emphasis added).

- 84. "Avalon" performed the modification, and installed the new engines and other goods it transferred to "Barclay" as an incident to providing such services, at the "Sandburg" hangar. Stip. ¶ 19. After "Avalon" completed the modification, "Barclay" inspected and accepted it pursuant to § 3.2 of the agreement. *See* Stip. ¶ 19; Stip. Ex. 32, p. 3 § 3.2.
- 85. Thereafter, on October 24, 1994, "Avalon" redelivered possession of the aircraft to "Barclay" by flying it from the "Sandburg" hangar to Indianapolis, Indiana, as agreed to by the parties. Stip. ¶ 19; Stip. Ex. 33 (copy of delivery receipt). There, "Iceberg" signed a delivery receipt for the aircraft. Stip. Ex. 33.
- 86. "Avalon" charged and collected Indiana sales tax from "Barclay" in the amount of \$113,250 regarding the sale of the items of tangible personal property transferred to "Barclay" and incorporated into the retrofit. Stip. ¶ 19a; Stip. Ex. 34, p. 2 (invoice). "Avalon" remitted this tax to the State of Indiana. Stip. ¶ 19a.
- 87. After "Avalon" redelivered possession of the aircraft to "Barclay", "Barclay" did not return the aircraft to the "Sandburg" hangar during the audit period. Stip. ¶ 19b.

Facts Regarding "Avalon's" Agreement With "Yates, Inc."

- 88. On or about June 27, 1994, "Yates, Inc." ("Yates") entered into a contract with "Avalon" for the modification of "Yates's" aircraft, a Falcon 20 bearing serial no. "1122". Stip. ¶ 20; Stip. Ex. 35.
- 89. Section 1.1 of that agreement states, in pertinent part, that:

... "Avalon" hereby agrees to sell to Buyer and Buyer agrees to purchase from "Avalon" an "ABCD" engine modification, more particularly described in Exhibit A, attached hereto and made a part hereof, (hereinafter referred to as "Modification"), upon the terms and conditions herein provided and in Exhibit A. Such Modification shall be performed on Buyer's Falcon 20, Series F Aircraft, Serial Number "432", Registration No. "N4AV2", (hereinafter referred to as "Aircraft").

Stip. Ex. 35, p. 1 § 1.1.

90. Section 3.2 of the agreement states:

When the Modification is complete and the Aircraft is ready for delivery to Buyer, the Installation Facility shall notify Buyer and Buyer shall promptly thereafter inspect the Aircraft at the Installation Facility to determine its compliance with Exhibit A. The Modification will comply with Service Bulletin 731, and proof of compliance will be demonstrated by a FAA form 337 approved by a FAA Inspector, and an entry into the Aircraft logbook. Such inspection, if requested by Buyer, may include an in-flight demonstration of the Aircraft, at Buyer's expense. Should such inspection reveal any discrepancies in the Modification, "Avalon" shall provide that they shall be corrected by the Installation Facility, at no expense to the Buyer. Buyer shall be allowed to verify all corrections and shall then be deemed to have accepted the Modification. Delivery of the Aircraft and Modification to Buyer may, by mutual agreement of the parties hereto, be at a later time and different location, provided that the Buyer takes delivery no later than seven (7) days after accepting the modification pursuant to the terms hereof. Should the Buyer fail to do so, delivery of the Aircraft and Modification shall be deemed to have taken place when buyer was deemed to have accepted the Modification.

Stip. Ex. 35, pp. 2-3 § 3.2 (emphasis added).

- 91. "Avalon" performed the modification, and installed the new engines and other goods it transferred to "Yates" as an incident to providing such services, at the "Sandburg" hangar. Stip. ¶ 20. After "Avalon" completed the modification, "Yates" inspected and accepted it pursuant to § 3.2 of the agreement. Stip. ¶ 20; Stip. Ex. 35, pp. 2-3 § 3.2.
- 92. Thereafter, on December 21, 1994, "Avalon" redelivered possession of the aircraft to "Yates" by flying it from the "Sandburg" hangar to Centennial airport in Colorado, as agreed to by the parties. Stip. ¶ 20; Stip. Ex. 26 (while the parties stipulated that delivery occurred in Denver, the copy of the delivery receipt shows that the plane was flown to Englewood, Colorado). There, "Iceberg" signed a delivery receipt for the aircraft. Stip. Ex. 26.
- 93. After "Avalon" redelivered possession of the aircraft, "Yates" did not return it to the "Sandburg" hangar during the audit period. Stip. ¶ 20.

## Other Facts Regarding The Provisions and Performance of the Contracts Admitted as Evidence

Each of the eleven modification contracts provide that "Title to all parts and materials that will be installed in the Aircraft during the Modification regardless of the manner of affixation or installation therein, shall not pass to the Buyer ... until the Buyer makes full payment of all amounts owed hereunder, accepts the Modification, and takes delivery of the Aircraft." Stip. ¶ 22; but see, 35 ILCS 115/2 ("Transfer' means any transfer of the title to property or of the ownership of property whether or not the transferor retains title as security for the payment of amounts due him from the transfer.") (emphasis added).

- 95. Within each modification agreement, "Avalon" gave separate express warrantees for the modification and for each engine it manufactured and transferred to others by installing them in aircraft at the "Sandburg" hangar. Stip. ¶ 23; Stip. Exs. 8, 11, 14, 16, 18, 20, 23, 25, 28, 30, 32, 35, 37 (Exhibit A, Section III § 4).
- 96. Generally, "Avalon's" modification warranty was that,

... the Articles [which include the "Avalon" "ABCD" engines, nacelles, pylon structures, Thrust Reversers (where applicable), other structures, system changes, parts and components described in Section of Exhibit A] and the installation thereof delivered hereunder conform to this Exhibit A and are free from defects in [...] materials and workmanship [...]. This warranty shall run to the Buyer, its successors, assigns and customers when they become the owner.

Stip. Exs. 8, 11, 16, 18, 20, 23, 25, 28, 30, 32, 35, 37 (Exhibit A, Section III § 4 of each agreement); *but see* Stip. Ex. 14 (warranty has slight variations where ellipses are situated in the above quoted language).

- 97. "Avalon's" modification warranty generally expired, "[f]ive hundred (500) Aircraft Operation Hours after delivery of the Aircraft to the Buyer as herein before provided, or [t]welve (12) months from the date of such delivery of the Aircraft to the Buyer, whichever first occurs." Stip. ¶ 23; Stip. Exs. 8, 14, 16, 18, 20, 23, 25, 32, 35, 37 (Exhibit A, Section III, § 4.3(a) to each agreement); but see Stip. ¶ 23 (footnote); Stip. Ex. 11 (Exhibit A, Section III, § 4.3(a)) (in agreement with "Lexicon", "Avalon's" modification warranty expired after 1,000 hours of aircraft operation, or after twenty-four (24) months, whichever came first).
- 98. "Avalon's" engine warranty generally expired, "[o]ne thousand eight hundred (1,800) Engine Operating Hours after delivery of the Aircraft to the Buyer pursuant to Section 3 of the Letter Agreement to which this Exhibit A is attached;

- or [s]ixty (60) months from the date of such delivery of the Aircraft to the Buyer, whichever first occurs." Stip. ¶ 23; Stip. Exs. 8, 14, 16, 18, 20, 23, 25, 32, 35, 37 (Exhibit A, (Section III § 4.3(b)) to each agreement); *but see* Stip. 23 (footnote); Stip. Ex. 11 (Exhibit A, Section III, § 4.3(b)) (in agreement with "Lexicon", "Avalon's" engine warranty expired after 1,000 hours of engine operation, or after thirty-six (36) months, whichever came first).
- 99. Each modification agreement provides that the buyer may take the aircraft to any "... warranty repair station authorized by ["Avalon"] ..." for warranty repairs. Stip. ¶ 24. There were a total of thirty-four (34) such service centers in twenty-three (23) states in the United States, and an additional thirty (30) service centers in seventeen (17) other countries around the world. Stip. ¶ 24; Stip Ex. 39 (copy of a 1993 booklet titled, Worldwide Authorized Service Center Network), pp. 15-21 (of exhibit).
- Inspiration" each provide that, "Title to all parts and materials installed in Customer's aircraft, regardless of affixation or installation therein, shall not pass to Customer ... until payment in full is made by the customer and received by ["Avalon"]." Stip. ¶ 25; but see 35 ILCS 115/2. "Aeronautic" and "Industrial" made final and full payments on these contracts after "Avalon" redelivered possession of the aircraft to the respective owners. Stip. ¶ 25; Stip Exs. 40-41 (respectively, the final invoice to "Aeronautic" and a preliminary invoice to "Industrial").

- 101. With regard to its agreements with "Aeronautic" and "Industrial", each provides that "Avalon" warranted its "workmanship and installation to conform to final specifications, plans, and drawings ... [for a period of] ninety (90) days after delivery of the aircraft to the customer." No warranty was given with respect to parts and materials. Stip. ¶ 26.
- When they were not being serviced at "Avalon's" Illinois hangar, all of the aircraft described in ¶¶ 9-21 of the parties' stipulation were hangared outside of the state of Illinois. Stip. ¶ 28. All of the owners of these aircraft were headquartered and domiciled outside of the state of Illinois. *Id.* No persons other than "Avalon" employees were on the aircraft during flights whereby "Avalon" redelivered possession of its customer's bailed aircraft to the respective owners. *Id.* No owners or employees of the owners of these aircraft were transported, or present, on these aircraft when the aircraft started, took off and flew from "Avalon's" "Sandburg" hangar to points outside Illinois. *Id.*
- Buyer's representatives be they pilots, aircraft maintenance directors or others were, however, present in Illinois for the inspection called for by each agreement, after "Avalon" notified the buyer that it had completed the modification or other services. Stip. Ex. 46, p. 4; *see* Stip. Exs. 8, 11, 14, 16, 18, 20, 23, 25, 28, 30, 32, 35, 37; Stip. Ex. 28, pp. 2 (¶ 13), 16; Stip. Ex. 30, pp. 2 (¶ 13), 8. Buyer representatives were also present in Illinois for other tests, inspections and approvals during the period when "Avalon" worked on the buyer's aircraft. Stip. Ex. 46, p. 4.

- 104. "Avalon's" "Sandburg", Illinois hangar had rooms available to be used by buyer's representatives when they stayed in Illinois to observe tests and inspections of aircraft "Avalon" was modifying or servicing, including the buyer's acceptance inspections of the modification and/or other work performed by "Avalon". Stip. Ex. 46, p. 3.
- 105. At the time it delivered aircraft outside Illinois, "Avalon" did not know if, when, or for what purpose, any of the aircraft would return to the "Sandburg" hangar. Stip. ¶ 29. It did, however, know that it warranted the work it performed in Illinois, and the new engines it installed there. Stip. Exs. 8, 11, 14, 16, 18, 20, 23, 25, 32, 35, 37 (Exhibit A, (Section III § 4.3(b)) to each agreement); Stip. Exs. 28, 30 (p. 2 ¶ 11 of each agreement). It also knew that its warranty services could be performed at its Illinois hangar. Stip. ¶ 23.

## Facts Regarding The Department's Audit of Taxpayer's Business

106. The Department conducted an audit of "Avalon's" operations at the "Sandburg" hangar for the period beginning January 1, 1992 through December 31, 1994. Stip. ¶ 5. During that period, the "Sandburg" hangar reported its Illinois sales and use tax liability under two different Illinois Business Tax Numbers. *Id.* For the period from January 1, 1992 through April 30, 1993, the "Sandburg" hangar had its own Illinois Business Tax ("IBT") Number 2030-8469. *Id.* From May 1, 1993 through December 31, 1994, the "Sandburg" hangar was included in a single "Avalon" IBT Number, 0000-0000, which was used to report the Illinois sales and use tax liabilities of all of "Avalon's" businesses. Stip. ¶ 5.

- 107. As a result of the audit, the Department issued three (3) Notices of Tax Liability to "Avalon". The first Notice (number SF-19990000000) was issued on June 24, 1999 to the "Sandburg" hangar's Illinois Business Tax Number 0000-0000, for the period January 1, 1992 through April 30, 1993. Stip. ¶ 6; Department Ex. 1, pp. 1 (copy of NTL). The other two Notices (numbers SF-19990000001 and SF-19990000002) were issued on July 23, 1999 to "Avalon's" Illinois Business Tax Number 0000-0001, for the periods January 1, 1992 through November 30, 1993, and December 1, 1993 through December 31, 1994, respectively. Stip. ¶ 6; Department Ex. 1, pp. 2-3 (copies of NTL's).
- 108. The two Notices dated July 23, 1999 are attributable solely to the audit of the "Sandburg" hangar. Stip. ¶ 6 n.2. Although the audit of Illinois Business Tax Number 0000-0001 encompassed other "Avalon" businesses unrelated to the "Sandburg" hangar, the additional tax due as a result of the audit of these other businesses was billed separately by the Department and paid by "Avalon". *Id*.
- 109. After the Department issued NTL No. SF-19990000001, it revised the Notice by issuing a Corrected Notice. Stip. ¶ 6; Department Ex. 1, p. 4 (copy of Corrected NTL). The Corrected Notice bears the same number and date as the original Notice, and is in all other respects identical to the original Notice, except it includes a penalty in the amount of \$61,285. Stip. ¶ 6; Department Ex. 1, p. 4. No penalty was included on the original NTL. Stip. ¶ 6.
- 110. The three NTL's assessed SOT as measured by "Avalon's" cost price of tangible personal property transferred by "Avalon", pursuant to eleven (11) modification contracts, and pursuant to two (2) other contracts. *See* Stip. ¶ 7. All thirteen (13)

- of these contracts were performed at the "Sandburg" hangar during the audit period. *Id*.
- 111. "Avalon" timely filed protests and requests for hearing in response to the NTL's issued. Stip. ¶ 8; Stip. Exs. 6-7 (copies of protests).
- 112. On December 1, 1993, a Department Administrative Law Judge ("ALJ") signed and sent a letter to "Avalon". Stip. ¶ 27; Stip. Ex. 42. This letter stated, in part, "... if you service an airplane in Illinois, arriving from an out-of-state destination, and destined for an out-of-state location, Service Occupation Tax will be incurred on the gross receipts of repairs if an owner, employee, or agent of the aircraft registrant is a passenger on the airplane when it departs Illinois subsequent to servicing." Stip. ¶ 27. The letter indicates that it was being sent in response to a telephone call, but does not indicate the facts or circumstances surrounding its issuance, or why "Avalon" or one of its employees might have telephoned an ALJ during an audit. *Id.*; 2 Ill. Admin Code § 1200.110(b) (procedures for obtaining information from the Department); 86 Ill. Admin. Code § 200.105 (definition of an administrative law judge in the Department's hearing regulations).

## **Facts Regarding the Penalty Assessed**

- 113. For the period from 1/1/92 through and including 4/30/93, the Department assessed a penalty of \$63,884 against "Avalon", under IBT number 0000-0000. Department Ex. 1, p. 1. That penalty was calculated as 10% of the tax the Department determined was due for that period. *Id*.
- 114. For the period from 1/1/92 through and including 11/30/93, a penalty of \$61,884, representing 10% of the tax due, was assessed against "Avalon", under IBT number 0000-0001. Department Ex. 1, p. 4

- 115. The tax and penalties assessed on those two NTL's were based on § 4 of the ROTA, which is incorporated by reference into the SOTA. Department Ex. 1, pp. 5, 7 (copies of the corrections of "Avalon's" returns for the respective NTL's); 35 ILCS 115/12.
- 116. A late payment penalty authorized by Illinois' Uniform Penalty and Interest Act ("UPIA") was included on the correction of returns prepared by the Department auditor for the period from 12/1/93 through and including 12/31/94, regarding IBT number 0000-0001. Department Ex. 1, p. 6. That penalty, however, was never assessed against "Avalon", as it did not appear on the NTL the Department issued to it on July 23, 1999. Department Ex. 1, p. 3.
- 117. On the NTL's on which penalties were assessed against "Avalon", the tax assessed included tax other than the SOT that was measured by the cost price of the new engines and other goods "Avalon" transferred to others as part of 13 disputed transactions. Department Ex. 2; Stip. Ex. 44 (audit workpapers for audit of taxpayer's business for the monthly periods beginning 1/1/92 through 4/30/93); Taxpayer's Brief, pp. 27-28.
- 118. Part of the penalty assessed was measured by tax that "Avalon" does not contest here. Taxpayer's Brief, pp. 27-28. Taxpayer does, however, contest the penalty that was measured by the undisputed amount of tax due. *Id*.
- 119. With regard to the penalty assessed as measured by the tax that "Avalon" does not dispute, the Department had previously audited "Avalon" regarding the same types of transactions as those giving rise to the undisputed amounts of tax.

  Department Ex. 2, pp. 4-5 (describing prior audit figures being used to determine

exception projections of taxable uses, transfers or sales of goods in amounts less than \$50,000, for purposes of use tax ("UT"), SOT and/or retailers' occupation tax ("ROT")); Stip. Ex. 44 (audit workpapers for monthly periods beginning 1/1/92 through 4/30/93), unnumbered pp. 6-8, 25, 38; Stip. Ex. 45 (audit workpapers for monthly periods beginning 5/1/93 through 12/31/94), unnumbered pp. 4-5, 7-8, 40.

- 120. As a result of that prior audit, the Department assessed either UT, SOT and/or ROT against "Avalon", as measured by the cost price of goods it either purchased for use or for transfer to others, or as measured by the gross receipts it received from selling goods to others. Department Ex. 2, pp. 4-5; Stip. Ex. 44, unnumbered pp. 6-8, 25, 38; Stip. Ex. 45, unnumbered pp. 4-5, 7-8, 40; Taxpayer's Brief, pp. 28-31.
- As to the 13 disputed transactions, "Avalon" knew that the modifications or other work that it performed on customers' aircraft were required by federal law to be certified as having been properly completed, before the aircraft would be approved for return to service within the United States. Stip. Exs. 8, 11, 14, 16, 18, 20, 23, 25, 32, 35, 37 (§ 3.2 of each agreement); Stip. Ex. 28, p. 16; Stip. Ex. 30, p. 8; 14 C.F.R. §§ 43.5-43.9.

### **Conclusions of Law**

The Illinois supreme court has held that:

... the intent of [the SOTA] was to place servicemen, as nearly as possible, on a tax parity with retailers to the extent that they perform the same economic function as retailers, viz., to the extent they transfer tangible personal property to the ultimate consumer. The object was to tax the incidental transfer of property which, due

to the accompanying and primary service function, fell outside the scope of the Retailers' Occupation Tax Act. [citations omitted] While the measure or base of the tax, the cost price to the serviceman of the materials transferred, did not coincide with the resale price of these materials (the measure under the Retailers' Occupation Tax Act), it was the most nearly equivalent measure of tax practicable under the circumstances since in the ordinary case it would be difficult to determine what percentage of a serviceman's total receipts was attributable to the mere transfer of property as opposed to the rendition of the service. Thus, this tax base eliminated the service as such from the onus of the tax, taxing the serviceman only in relation to the extent that, in the manner of a retailer, he was a seller of property to the ultimate user.

Fiorito v. Jones, 39 Ill. 2d 531, 536-37, 236 N.E.2d 698, 702 (1968).

Consistent with that intent, the Illinois General Assembly incorporated into the SOTA several statutory provisions that are also included within the ROTA. 35 **ILCS** 115/12. One of the incorporated sections is § 4 of the ROTA, which provides, in pertinent part:

As soon as practicable after any return is filed, the Department shall examine such return and shall, if necessary, correct such return according to its best judgment and information. ... In the event that the return is corrected for any reason other than a mathematical error, any return so corrected by the Department shall be prima facie correct and shall be prima facie evidence of the correctness of the amount of tax due, as shown therein. \*\*\*

#### 35 **ILCS** 120/4.

At hearing, the Department introduced copies of the NTL's it issued to "Avalon" into evidence. Stip. Exs. 1-3, 5. Pursuant to § 12 of the SOTA, that NTL constitutes prima facie proof of the correctness of the amount of tax due. 35 **ILCS** 115/12. The Department's prima facie case is a rebuttable presumption. Copilevitz v. Department of Revenue, 41 Ill. 2d 154, 157, 242 N.E.2d 205, 207 (1968); DuPage Liquor Store, Inc. v. McKibbin, 383 Ill. 276, 279, 48 N.E.2d 926, 927 (1943). A taxpayer cannot overcome the presumption merely by denying the accuracy of the Department's assessment. Mel-Park Drugs, Inc. v. Department of Revenue, 218 Ill. App. 3d 203, 217, 577 N.E.2d 1278, 1287 (1st Dist. 1991). Instead, a taxpayer has the burden to present evidence that is consistent, probable and closely identified with its books and records, to show that the assessment is not correct. Fillichio v. Department of Revenue, 15 Ill. 2d 327, 333, 155 N.E.2d 3, 7 (1958); A.R. Barnes & Co. v. Department of Revenue, 173 Ill. App. 3d 826, 833-34, 527 N.E.2d 1048, 1053 (1st Dist. 1988).

Prior to the hearing, the parties agreed that the issue to be resolved is whether "Avalon's" transfers of tangible personal property as an incident to its sales of service were exempt under § 3-45 of the SOTA. Pre-Hearing Order, dated 11/16/00. In its post-hearing brief, "Avalon" admits that it is a serviceman, and thus, that it is subject to SOT. Taxpayer's Brief, p. 8. It argues, however, that its

cost price of the goods it transferred to others when performing services pursuant to the different contracts introduced as evidence is not subject to SOT because those transactions were transactions in interstate commerce, and are exempt from taxation pursuant to § 3-45 of the SOTA. *Id.* (*citing* 35 **ILCS** 115/3-45). Taxpayer's Brief, *passim*.

Section 3-45 of the SOTA provides:

Interstate commerce exemption. No tax is imposed under this Act upon the privilege of engaging in a business in interstate commerce or otherwise when the business may not, under the Constitution and statutes of the United States, be made the subject of taxation by this State.

35 **ILCS** 115/3-45. Pursuant to the Illinois General Assembly's express grant of authority in the SOTA, the Department has promulgated a regulation interpreting the interstate commerce exemption. 35 **ILCS** 115/11-12; 35 **ILCS** 120/12. The regulation is § 140.501, and its first two paragraphs provide:

Sales of Service Involving Property Originating in Illinois Where tangible personal property is located in this State at the time of its transfer (or is subsequently produced in Illinois) as an incident to a sale of service, and is then delivered in Illinois, the serviceman incurs Service Occupation Tax liability on the selling price of the property. The sale is not deemed to be in interstate commerce if the purchaser or his representative receives the physical possession of such property in this State. This is so notwithstanding the fact that the purchaser may, after receiving physical possession of the property in this State, transport or send the property out of the State for use outside the State or for use in the conduct of interstate commerce. The place at which the contract of sale of the service or contract to sell the service is negotiated and executed and the place at which title to the property passes to the purchaser are immaterial. The place at which the purchaser resides is also immaterial. Except as is set out at Section 140.501(d) of this Part, it also makes no difference that the purchaser is a carrier when that happens to be the case. The serviceman does not incur Service Occupation Tax liability on property which he resells as an incident to a sale of service under an agreement by which the serviceman is obligated to make physical delivery of the goods from a point in this State to a point outside this State, not to be returned to a point within this State, provided that such delivery is actually made. Nor does the tax apply to property which the serviceman resells as an incident to a sale of service under an agreement by which the serviceman, by carrier (when the carrier is not also the purchaser) or by mail, delivers the property from a point in this State to a point outside this State, not to be returned to a point within this State. The place at which title to the property passes to the purchaser is immaterial. The place at which the contract of sale of the service or contract to sell the service is negotiated and executed and the place at which the purchaser resides are also immaterial. Sales of service of the type described in this paragraph are deemed to be within the protection of the Commerce Clause of the Constitution of the United States.

86 Ill. Admin. Code § 140.501; 14 Ill. Reg. 262 (eff. January 1, 1990).

The regulation, therefore, distinguishes between transactions that are or are not in interstate commerce based on whether the serviceman delivers the goods he transfers incident to his sale of service to the customer in Illinois. If the serviceman delivers physical possession of the goods to the customer in Illinois, then the transaction is not in interstate commerce, even though the customer "... may, after receiving physical possession of the property in this State, transport or send the property out of the State for use outside the State or for use in the conduct of interstate commerce." 86 Ill. Admin Code § 140.501(a). If, however, the serviceman "... make[s] physical delivery of the goods from a point in this State to a point outside this State, not to be returned to a point within this State, ..." the transaction is in interstate commerce, "... provided that such delivery is actually made." 86 Ill. Admin Code § 140.501(b).

This contested case involves the parties' dispute over whether "Avalon" delivered physical possession of the new aircraft engines and other goods it installed onto or into aircraft to its customers in Illinois. The Department argues that it did (Department's Brief, p. 4), "Avalon" claims it did not. Taxpayer's Reply, pp. 6-7.

# Did "Avalon" Deliver Physical Possession of the Engines and Other Goods It Installed In Others' Aircraft, in Illinois

The Department concedes, as it must, that "Avalon" delivered the customers' *aircraft* outside Illinois (Department's Brief, p. 3; Stip. ¶ 28), but it expressly argues that,

\*\*\* All of the services necessary to repair or retrofit the subject aircraft were performed in Illinois. The tangible personal property transferred as an incident to the performance of the service was located in Illinois at the time of its transfer and by incorporating that property into an aircraft owned by its customer, *the Taxpayer has transferred possession of the property to the customer or his representative, in Illinois*, thereby subjecting it [to] taxation.

Department's Brief, p. 4 (emphasis added). Thus, the Department distinguishes between the goods "Avalon" actually transfers incident to its sales of service — the new aircraft engines and other goods it installs into its customers aircraft — and the aircraft into which such goods were installed. *See id.* ("The Department is not attempting to tax the airplane, if that were the case Taxpayer's position might have some validity. ... The Department seeks to tax the cost price of certain tangible personal property transferred incident to a sale of service and incorporated into an aircraft already owned by the Taxpayer's customer.").

The Department further asserts that:

\*\*\* By incorporating the tangible personal property transferred as an incident to the retro-fit and repair service into airplanes owned by its customers, the property became a part of the aircraft itself and possession of that property was transferred by the Taxpayer to its customers in Illinois. It is, therefore, unquestionably clear that the Taxpayer delivered that tangible personal property to its customers by transferring physical possession of the property to its customers in Illinois. The transfer of the property is subject to the application of the tax.

Department's Brief, pp. 4-5.

In contrast, taxpayer never distinguishes between the engines and other goods it installed into or onto other's aircraft in Illinois and the aircraft themselves. In its brief, for example, when arguing that the transactions were exempt pursuant to SOT regulation § 140.501(b), it asserts:

> First, the serviceman must resell tangible personal property incident to a sale of service. There is no dispute that "Avalon's" work on the thirteen aircraft qualifies under this provision. "Avalon" refurbished business aircraft and during the course of its work, purchased, installed and re-

> sold tangible personal property. (Stip. ¶¶ 3, 4).
>
> Second, the serviceman must be obligated to physically deliver the goods from a point within Illinois to a point outside of Illinois. Again, there is no dispute that these thirteen transactions qualify on this point. (Stip. ¶¶ 9-21).
>
> Third, after delivery outside of Illinois, the property is "not the boundary of the property is "not the boundary of the property is "not the boundary of the property is "not the property is "not the property is "not be property is "not be

"not to be returned to a point within" Illinois. While "Avalon" believes it has met the only plausible interpretation of this final requirement, the Department has taken a contrary position.

Taxpayer's Brief, p. 9.

"Avalon" did not directly address the Department's contention in its initial brief. That, most likely, is because the largest part of "Avalon's" initial brief is dedicated to arguing that SOT should not be assessed against it based on a nonresident customer's act of flying the aircraft into Illinois after "Avalon" delivered the modified aircraft to the customer. Taxpayer's Brief, passim. That argument, in turn, is premised upon certain advice relayed to the Department employee who conducted the audit, which advice is included in his audit comments. Department Ex. 2, pp. 3-4, 7 (copy of Auditor's Comments); Stip. Exs. 43, 46. In the Department's brief, however, it expressly disavows the substance of the advice the audit supervisor passed on to the auditor, that a customer's return of an aircraft into Illinois acts as a waiver of the interstate commerce exemption. Department's Brief, p. 5. Rather, the Department's sole basis for upholding the SOT assessed here is because "Avalon" delivered physical possession of the goods it installed into or onto other's aircraft, to the customers in Illinois. Department's Brief, pp.4-5; *see also* 86 Ill. Admin. Code § 140.501.

After being directly confronted with the Department's argument, "Avalon" asserts, in parentheses, that its delivery of an owner's aircraft constitutes its delivery of the goods it installed therein. Specifically, it argues that:

The stipulated facts agreed to ... recite clearly, and document, the physical delivery of the thirteen aircraft (and therefore the physical delivery of the tangible personal property incorporated into the aircraft) from "Avalon" to its customers at locations outside Illinois. In each of the thirteen transactions, when the retrofit or modification services were completed, (1) the aircraft were "returned to and accepted by" "Avalon's" customers at the out-of-state locations (Stip. ¶¶ 9-21); (2) no owners, or employees of the owners of the aircraft were on board the aircraft, or present, when the aircraft left Illinois and flew to the delivery location (Stip. ¶ 28); and (3) when each owner received possession of the aircraft at a delivery location outside of Illinois (and therefore received possession of the tangible personal property incorporated by the aircraft), [sic] the owner documented such receipt by executing a Final Acceptance and Delivery Agreement. (Stip. ¶¶ 9-21; Exs. 9, 12, 15, 17, 19, 21, 24, 26, 29, 31, 33, 36, 38). Without a physical delivery of property to "Avalon's" customers in Illinois, the Service Use Tax cannot be sustained under Section 140.501(a).

Taxpayer's Reply Brief (Taxpayer's Reply"), pp. 6-7.

But again, "Avalon" does not transfer an aircraft to its customers incident to its sales of service. That is why it is imperative to distinguish between, on one hand, the new engines and other goods "Avalon" installs in others' aircraft and, on the other hand, the aircraft into which such goods are installed. Tax is being assessed on "Avalon's" occupation as a serviceman, and is measured by

the cost price of the goods it transfers incident to its sales of service in Illinois. 35 **ILCS** 115/2; <u>Fiorito v. Jones</u>, 39 Ill. 2d at 538-39, 236 N.E.2d at 703 (SOT is levied not on the service, but on the incidental transfer of personal property by the serviceman). Since "Avalon" concedes that it is a serviceman (Taxpayer's Brief, p. 8), and it has stipulated that it purchased, installed and re-sold tangible personal property incident to its sales of service in Illinois (*Id.*; Stip. ¶¶ 3-4), those concessions alone trigger the statutory presumption that all of the engines and other goods delivered to "Avalon" in Illinois by a supplier were delivered for transfer incident to a sale of service. 35 **ILCS** 115/4.

Second, while there is no dispute that "Avalon" is a seller or transferor of the goods it installs into its customer's aircraft, it is not a transferor of its customer's aircraft. Rather, as Illinois law clearly provides, "Avalon" is a bailee of that property, just as any person engaged in the business of repairing or servicing other people's property is a bailee of the property they service. Clark v. Fields, 37 Ill. 2d 583, 229 N.E.2d 676 (1967) (person who took possession of another's aircraft to repair it was a bailee); Fuller's Car Wash, Inc. v. Liberty Mutual Insurance Co., 298 Ill. App. 3d 167, 174, 698 N.E.2d 237, 242-43 (2<sup>nd</sup> Dist. 1998) (customer's delivery of car to employee of full-service car wash created bailment); see also, 8A Am. Jur. 2d Aviation § 38 (Bailment or Lease of Airplane) (1997) ("The delivery of an airplane to a mechanic for the purpose of repairs also creates the relation of bailor and bailee ...."); 8A Am. Jur. 2d Bailments § 9 (Lucrative Bailments, Bailments for Mutual Benefit) (1997) ("A mutual benefit bailment is created when a chattel is delivered by its owner to another for repairs, service, or alteration."). A bailment occurs when someone delivers possession of tangible or intangible personal property to another for a particular purpose, after which the property is to be returned to the person delivering it. Interlake, Inc. v. Kansas Power & Light Co., 79 Ill. App. 3d 679, 682-83, 398 N.E.2d 945, 948 (1st Dist. 1979); 8A Am. Jur. 2d Bailments § 1 (Bailment Relationship, Generally) (1997) ("A bailment is created by the delivery of personal property by one person to another in trust for a specific purpose, pursuant to an express or implied contract to fulfill that trust. \*\*\*").

The Department's contention that "Avalon" delivered physical possession of the goods it installed in its customers aircraft to its customers in Illinois, is supported by overwhelming documentary evidence in the record. Perhaps most fundamentally, the Department's contention is supported by the very nature of the business "Avalon" conducts in Illinois, which is stipulated. Stip. ¶¶ 3, 7. "Avalon's" business requires it to physically install new, and sometimes used, goods into and onto other's aircraft, within Illinois. Stip. ¶ 3; Stip. Exs. 8, 11, 14, 16, 18, 20, 23, 25, 32, 35, 37 (§ 1.1 & Exhibit A of each agreement); Stip. Exs. 28, 30 (p. 2  $\P$ ¶ 1-2, 6, 10 of each agreement).

The purpose for the bailment of its customer's aircraft is described on page 1 and § 1.1 of each of "Avalon's" modification agreements, and within the descriptive text of its other agreements. Stip. Exs. 8, 11, 14, 16, 18, 20, 23, 25, 32, 35, 37 (p. 1, § 1.1 of each agreement); Stip. Exs. 28, 30. The written agreements themselves clearly show that "Avalon" distinguishes between the parties' obligations regarding delivery of the modification or alteration, and their obligations regarding redelivery of possession of the bailed aircraft to the owner. Section 3.1 of each modification agreement details each aircraft owner's obligation to deliver possession of its aircraft to "Avalon" by flying it to "Avalon's" Illinois hangar, and "Avalon's" obligation to inspect the aircraft, inter alia, for fitness for the alterations to be made. Stip. Exs. 8, 11, 14, 16, 18, 20, 23, 25, 32, 35, 37 (§ 3.1 of each agreement). Section § 3.2 of each modification agreement then details the parties' separate and distinct obligations regarding the delivery and acceptance of the modification, and regarding "Avalon's" further obligation to redeliver possession of the owner's aircraft, once the purpose for the bailment, i.e., the modification or other services, is complete. Stip. Exs. 8, 11, 14, 16, 18, 20, 23, 25, 32, 35, 37 (§ 3.2 of each agreement); 8A Am. Jur. 2d Bailments § 1 ("\*\*\* Inherent in the bailment relationship is the requirement that the property be returned to the bailor, or duly accounted for by the bailee, when the purpose of the bailment is accomplished ....").

Sections 3.1 and 3.2 also reflect the obligations the applicable federal regulations impose on persons who, like "Avalon", provide services that include "... the complete disassembly, repair, reassembly, and functionality test[ing] of aircraft engines; service and repair of aircraft airframes, avionics, and aircraft interiors; ... removal and replacement of accessories and components; and retrofits of business jet aircraft." Stip. ¶ 3. Just about every aspect of aircraft ownership, operation and safety within in the United States, including the maintenance and repair of aircraft, and the certification of persons who perform such services, like "Avalon", come under the regulatory authority of the Federal Aviation Administration. See generally 49 U.S.C. §§ 40101-50101 *et seq.*; 14 C.F.R. §§ 43.1-43.17 *et seq.* 

Consistent with that federal regulatory oversight of taxpayer's business, all of "Avalon's" modification agreements expressly provide that, upon its completion of the modification work, "[t]he Modification will comply with Service Bulletin 731, and proof of compliance will be demonstrated by a FAA Form 337 approved by a FAA inspector [...] and an entry into the Aircraft logbook." Stip. Exs. 8, 11, 14, 16, 18, 20, 23, 25, 32, 35, 37 (§ 3.2 of each agreement). The two contracts pursuant to which "Avalon" agreed to install, *inter alia*, alterations of or improvements to the craft's avionics systems also required "Avalon" to provide FAA Forms 337 and/or other FAA forms, as required. Stip. Ex. 28, p. 16; Stip. Ex. 30, p. 8. Those forms provide a number of functions, but the effect of them for purposes of this case is that, as a practical matter, the federally required testing and certification that is part of making such goods component parts of aircraft must be performed in the place where the repairs or alterations are made — in this case, in Illinois — or, as a matter of federal law, the aircraft cannot be flown *anywhere*. 14 C.F.R. § 43.5; Stip. Ex. 46, p. 4 ("FAA certification that the aircraft is airworthy is made at the service repair facility after extensive testing has been performed on the ground and in the air.").

Section 3.2 of each modification agreement provides that after "Avalon" completes the agreed-upon modification, it will notify the owner that the work is complete. Stip. Exs. 8, 11, 14, 16, 18, 20, 23, 25, 32, 35, 37 (§ 3.2 of each agreement). "Avalon" further agrees that, when its

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In some of the modification agreements, the text of § 3.2 accounts for the possibility that the Installation Facility performing the modification might be located in a country other than the United States. In that case, the form "Avalon" would use to establish compliance with Service Bulletin 731 would not be a FAA form, and the person who signs the appropriate form would have been licensed by an agency other than the FAA.

modification work is complete, it will be able to prove that its work is in compliance with the agreed upon standard, Service Bulletin 731, by tendering a completed FAA Form 337, and by entering the appropriate information in the aircraft's logbook. Stip. Exs. 8, 11, 14, 16, 18, 20, 23, 25, 32, 35, 37 (§ 3.2 of each agreement); *see also* 14 C.F.R. § 43.5(a)-(b) (the person who approves the aircraft or aircraft unit as being fit for return to service must, respectively, enter the repair or alteration into the maintenance record required by 14 C.F.R.§§ 43.9 or § 43.11, and complete the appropriate form for the repair or alteration, e.g., a FAA Form 337).

The buyer, in turn, agrees that, after being notified that the modification was complete, it will promptly inspect the aircraft in "Sandburg", Illinois. Stip. Exs. 8, 11, 14, 16, 18, 20, 23, 25, 32, 35, 37 (§ 3.2 of each agreement). After that inspection and the buyer's receipt of proof (i.e., the completed FAA Form 337) showing that "Avalon's" work meets the agreed-upon standard, the buyer agrees that it will accept the modification, or that it will be deemed to have accepted the modification. Stip. Exs. 8, 11, 14, 16, 18, 20, 23, 25, 32, 35, 37 (§ 3.2 of each agreement). When a buyer accepts the modification, it also accepts the engines or other goods "Avalon" has installed in the aircraft. See Stip. Exs. 8, 11, 14, 16, 18, 20, 23, 25, 32, 35, 37 (§ 1.1 and Exhibit A of each agreement).

In a nutshell, it is only when a customer accepts "Avalon's" work, including the engines and other goods installed in the aircraft as part of that work, that "Avalon" will agree to redeliver possession of the customer's bailed aircraft by flying it from Illinois to somewhere else. If, however, the owner does not come into Illinois to inspect its aircraft, or if the owner does not agree to take repossession of the aircraft by having "Avalon" fly it to the owner within 7 days of accepting the modification and goods, then "... delivery of the Aircraft and Modification shall be deemed to have taken place when the Buyer was deemed to have accepted the Modification." *E.g.*, Stip. Ex. 8, p. 4 § 3.2. The clear import of that provision is that, in the event of a buyer's noncompliance with the terms of § 3.2, or in the event a customer does not want "Avalon" to redeliver possession of the plane by flying it outside Illinois, "Avalon" will redeliver possession of the aircraft to the customer by making it available to be picked up by the customer at "Avalon's" Illinois hangar. Stip. Exs. 8, 11, 14, 16, 18, 20, 23, 25, 32, 35, 37 (§ 3.2 of each agreement). Either way, the text of § 3.2 is clear that "Avalon" will not undertake to redeliver possession of a customer's bailed aircraft anywhere unless the customer has first come into Illinois to inspect the work it performed, and then accepted that work.

Taxpayer's argument that it delivers physical possession of the new engines and other goods that it installed into or onto that aircraft only once it flies the aircraft back to the customer, therefore, completely disregards the distinction its own contracts make between the delivery of the

modification, which *must* occur in Illinois, and "Avalon's" redelivery of the customer/bailor's aircraft, which *may or may not* occur in Illinois. The customer's acceptance of "Avalon's" work — while the aircraft is still in Illinois — is an express condition precedent of "Avalon's" willingness to redeliver possession of the aircraft to the customer by flying it from its Illinois hangar to anywhere else. *See* <u>Vuagniaux v. Korte</u>, 273 Ill. App. 3d 305, 309, 652 N.E.2d 840, 842 (5<sup>th</sup> Dist. 1995). ("A condition precedent is defined as an event which must occur or an act which must be performed by one party to an existing contract before the other party is required to perform. ... The obligations of the parties end in the event that a condition precedent is not satisfied.") (*quoting* <u>Maywood Proviso</u> <u>State Bank v. York State Bank & Trust Co.</u>, 252 Ill. App. 3d 164, 168, 625 N.E.2d 83, 87 (1993)) (internal quotation marks omitted). Yet here, "Avalon" does not once, in either of its briefs, refer to the required buyer inspections of the modification services and goods installed pursuant thereto.

"Avalon" also argues that each of the 13 transactions at issue here were complete only when it delivered the aircraft to the customer outside Illinois. Taxpayer's Brief, p. 19. That argument, however, again disregards the express condition that "Avalon" would not undertake to deliver a customer's aircraft unless and until the principle services it contracted to provide were accepted by the customer. Recall that the legislative intent underlying the SOT was "... to place servicemen, as nearly as possible, on a tax parity with retailers to the extent that they perform the same economic function as retailers, ... to the extent they transfer tangible personal property to the ultimate consumer." Fiorito v. Jones, 39 Ill. 2d at 536-37, 236 N.E.2d at 702. There is no doubt that all of "Avalon's" agreements in evidence contractually required it to provide services other than its installation of goods into an aircraft in Illinois. For example, like some manufacturer/retailers, "Avalon" granted each modification customer a warranty for the goods it installed onto its aircraft, and it gave a separate warranty for its work. Stip. ¶¶ 23-24. It also agreed to provide training to the customer's pilots or other employees or agents at certain facilities on the new engines or other systems it installed. Stip. Exs. 8, 11, 14, 16, 18, 20, 23, 25, 32, 35, 37 (Exhibit A, Section III § 2.2 of each agreement).

But, "... to the extent that ["Avalon"] perform[ed] the same economic function as retailers, ... [that is,] to the extent [it] transfer[red] tangible personal property to the ultimate consumer" (Fiorito v. Jones, 39 Ill. 2d at 536-37, 236 N.E.2d at 702), its transfers of the goods it installed into its customers aircraft were complete, that is, it delivered physical possession of those goods to its customers, either once it made them fully functioning component parts of its customer's airworthy aircraft, or once the customer came into Illinois and, after inspecting the such goods and "Avalon's" work, accepted that work. Stip. Exs. 8, 11, 14, 16, 18, 20, 23, 25, 32, 35, 37 (§ 3.2 of each agreement);

Stip. Ex. 28, p. 16; Stip. Ex. 30, p. 8; see also 810 **ILCS** 5/2-606 ("What constitutes acceptance of goods").<sup>3</sup> Illinois cases decided under the ROTA or other analogous contexts support this conclusion.

In a retail context, and in cases in which interstate commerce objections were invoked, the Illinois supreme court has held that "... when a purchaser in a sale in Illinois takes delivery of the goods in Illinois, the sale is not in interstate commerce and is taxable under State law, though the purchaser immediately takes the goods out of Illinois for use outside of Illinois." American Airlines v. Department of Revenue, 58 Ill. 2d 251, 259, 319 N.E.2d 28, 33 (1974). Similarly, when a nonresident sends its own transportation equipment into Illinois to pick up tangible personal property purchased from a retailer who maintains a place of business here, and intending to take the goods outside Illinois for use, Illinois courts have consistently upheld the assessment of tax on the retailer, because all of the incidents necessary for the imposition of ROT have been met. So, almost fifty years ago, the Illinois supreme court, in Pressed Steel Car Co. v. Lyons, 7 Ill. 2d 95, 129 N.E.2d 765 (1955), upheld the imposition of tax on a retailer who sold coal to a rail carrier that loaded the coal onto its rail cars in Illinois, even though the carrier transported the goods outside Illinois for use.

In <u>Superior Coal Co. v. Department of Finance</u>, 377 Ill. 282, 36 N.E.2d 354 (1941), a decision rendered 10 years before <u>Pressed Steel Car Co.</u>, the court held that coal mined, sold, and delivered to

3 Section 2-606 of Illinois' Commercial Code provides:

What constitutes acceptance of goods.

- (1) Acceptance of goods occurs when the buyer
- (a) after a reasonable opportunity to inspect the goods signifies to the seller that the goods are conforming or that he will take or retain them in spite of their non-conformity; or
- (b) fails to make an effective rejection (subsection (1) of Section 2--602, but such acceptance does not occur until the buyer has had a reasonable opportunity to inspect them; or
- (c) does any act inconsistent with the seller's ownership; but if such act is wrongful as against the seller it is an acceptance only if ratified by him.

\* \* \*

### 810 **ILCS** 5/2-606.

There is no mistaking the fact that, when drafting § 3.2 of its modification agreements, "Avalon" mirrored the acts the UCC describes as constituting a customer's acceptance of goods, regardless whether the UCC applies to the agreements and/or transactions at issue here. *Compare id. with* Stip. Exs. 8, 11, 14, 16, 18, 20, 23, 25, 32, 35, 37 (§ 3.2 of each agreement); *see also* 810 **ILCS** 5/2-102; <u>Tivoli Enterprises, Inc. v. Brunswick Bowling & Billiards Corp.</u>, 269 Ill. App. 3d 638, 646 N.E.2d 943 (2<sup>nd</sup> Dist. 1995) (upholding the use of the "predominant purpose test" to determine whether an agreement falls within article 2 of the UCC); <u>Bob Neiner Farms, Inc. v. Hendrix</u>, 141 Ill. App. 3d 499, 501-02, 490 N.E.2d 257, 258-59 (3<sup>rd</sup> Dist. 1986) (citing Illinois cases using the predominant purpose test); Sonja A. Soehnel, Annotation, *Applicability of UCC* 

the seller's parent company's railway in Illinois for use outside the state was not exempt from ROT under the interstate commerce exemption. Superior Coal Co., 377 Ill. at 295-96. Some twenty years after Pressed Steel Car Co., the same principle was again upheld in International-Stanley Corp. v. Department of Revenue, 40 Ill. App. 3d 397, 352 N.E.2d 272 (1st Dist. 1976). There, the court held that a retailer's sales of grain doors that it delivered to a purchasing railroad by placing them on the railroad's railcars in Illinois were subject to ROT, but that doors the retailer delivered to the purchasing railroad outside of Illinois were not subject to ROT. Id. at 407, 352 N.E.2d at 280.

Similarly, for Illinois Use Tax Act "("UTA") purposes, the Illinois supreme court has upheld the Department's assessment of use tax on a carrier's withdrawal of airline fuel purchased outside and stored within Illinois, and which it then loaded onto its aircraft in Illinois. United Air Lines, Inc. v. Mahin, 49 Ill. 2d 45, 273 N.E.2d 585 (1971), vacated and remanded, 410 U.S. 623, 93 S.Ct. 1186, 35 L.Ed.2d 545 (1973), judgment aff'd following remand, 54 Ill.2d 431, 298 N.E.2d 161 (1973).4 The court rejected the owner's argument that the fuel was being "temporarily stored" within the aircraft's tanks, prior to its use in interstate commerce. United Air Lines, Inc., 49 Ill. 2d at 52, 273 N.E.2d at 588 ("The placing and presence of the fuel in the tanks of aircraft may be 'storage' in a special or technical sense, but we think it clear that the legislature did not intend for the temporary storage exemption to extend to 'storage' of such nature.").

Here, each customer flew its airplane into Illinois for the express purpose of purchasing "Avalon's" services, as well as the engines and/or other goods that came with those services. Stip. Exs. 8, 11, 14, 16, 18, 20, 23, 25, 32, 35, 37 (§§ 1.1, 3.1 of each agreement); Stip. Exs. 28, 30 (p. 2 ¶¶ 1-2, 6-7, 11 of each agreement). Each aircraft remained in Illinois for months, as "Avalon" rendered its services. Compare Stip. Exs. 8, 11, 14, 16, 18, 20, 23, 25, 28, 30, 32, 35, 37 (date of each contract) with Stip. Exs. 9, 12, 15, 17, 19, 21, 24, 26, 29, 31, 33, 36, 38 (date of aircraft delivery receipt). Each owner had the right to be present at "Avalon's" Illinois facilities, either to observe "Avalon's" work on its aircraft, or to make the inspections called for by their respective agreements. Stip. Exs. 8, 11, 14, 16, 18, 20, 23, 25, 32, 35, 37 (§ 3.2 of each agreement); Stip. Exs. 28, 30 (p. 2 ¶ 13 of each agreement). All of the goods "Avalon" transferred to a customer incident to its sales of service were installed in

Article 2 To Mixed Contracts For Sale of Goods and Services, 5 A.L.R. 4th 501 (1981 & 2000) Supp.), § 3 (citing cases applying Illinois law).

The Illinois General Assembly later made an interstate carrier for hire's purchase and/or use of aircraft fuel loaded onto aircraft in Illinois, and on an interstate carrier for hire's purchase and/or use of any goods used as rolling stock in Illinois (including component parts thereof), exempt from UT or ROT. 35 ILCS 105/3-5(12), 3-60; 35 ILCS 120/2-5(12), (22). The exemption, however, does not extend to users such as "Avalon's" customers in this case, who are not carriers for hire. Admiral Disposal Co. v. Department of Revenue, 302 Ill. App. 3d 256, 259-60, 706 N.E.2d 118, 120-21 (2<sup>nd</sup> Dist. 1999); Stip. ¶ 3.

Illinois, and all of the federally required tests and inspections were conducted in Illinois. Stip. ¶¶ 3, 5-7; Stip. Exs. 8, 11, 14, 16, 18, 20, 23, 25, 32, 35, 37 (§ 3.2 of each agreement); Stip. Ex. 28, p. 16, Stip. Ex. 30, p. 8; Stip. Ex. 46, p. 4 ("The master contract for engine retrofits states that the customer must inspect and accept the engines at the service repair facility prior to departure."). Each contract introduced as evidence called for a final inspection to be conducted in Illinois, once "Avalon's" modification or installation services were complete. Stip. Exs. 8, 11, 14, 16, 18, 20, 23, 25, 32, 35, 37 (§ 3.2 of each agreement); Stip. Ex. 28, p. 16, Stip. Ex. 30, p. 8.

What <u>Superior Coal Co.</u>, <u>Pressed Steel Car Co.</u>, <u>International-Stanley</u> and <u>United Airlines</u> all have in common is that, in the transactions found subject to tax in those cases, the goods that were sold or purchased were loaded onto property, in Illinois, that was owned or used by the purchaser. Crucially similar facts exist in this matter. Here, each customer flew its aircraft into Illinois expressly to purchase "Avalon's" services, and directed that its aircraft remain in Illinois so that "Avalon" could perform a modification or retrofit on the aircraft. Stip. Exs. 8, 11, 14, 16, 18, 20, 23, 25, 32, 35, 37 (§§ 1.1, 3.1-3.2 of each agreement); Stip. Exs. 28, 30, *passim*. Thus, each customer was physically present in Illinois when "Avalon" installed the engines and/or other goods into or onto its aircraft, simply because each customer's property, its aircraft, was in Illinois expressly for that purpose.

After considering the documentary evidence in this record, as well as the pertinent legal decisions, I conclude that "Avalon" delivered physical possession of the goods it transferred to customers incident to its sales of service when it completed its installation of the goods into or onto each aircraft, so that they became fully-functioning component parts of the customer's aircraft. Stip. Exs. 8, 11, 14, 16, 18, 20, 23, 25, 32, 35, 37 (§§ 1.1, 3.1 of each agreement); Stip. Exs. 28, 30 (p. 2 ¶ 1 of each agreement); 35 ILCS 115/2 (definition of "transfer"); Exhibits, Inc. v. Sweet, 303 Ill. App. 3d 423, 429, 709 N.E.2d 236, 240 (1st Dist. 1998) (naming Superior Coal Co. a case that "... indicate[s] that the point of possession or delivery is a controlling factor when determining whether to apply the [ROTA]."). Because of the very nature of its business, taxpayer delivered the goods to its customer in Illinois by physically installing them into or onto the customer's aircraft, at its Illinois hangar. Stip. ¶¶ 3, 13. As a practical matter, this means that "Avalon" delivered physical possession of the goods to the customer when it satisfied its contractual, and federally required, obligation to have all of its installation work certified as being properly completed, and its customer's aircraft certified as being airworthy, by a FAA inspector. Stip. Exs. 8, 11, 14, 16, 18, 20, 23, 25, 32, 35, 37 (§ 3.2 of each agreement); Stip. Ex. 28, p. 16; Stip. Ex. 30, pp. 8-9; 14 C.F.R. §§ 43.5(a)-(b) (requiring FAA approval for return to service of aircraft, or component part thereof, after maintenance, preventive maintenance, rebuilding, or alteration of aircraft or part), 43.9 (Content, form, and disposition of maintenance, rebuilding, and alteration records).

In the event that "Avalon" does not deliver physical possession of the new engines and other goods it installs into or onto its customer's aircraft at the time it makes them fully functioning component parts thereof, however, the SOT still applies to the transactions at issue. At the latest, "Avalon" delivers physical possession of the goods it transfers incident to its sales of service when its customers come into Illinois and accept the goods and related services "Avalon" has provided. Stip. Exs. 8, 11, 14, 16, 18, 20, 23, 25, 32, 35, 37 (§ 3.2 of each agreement); Stip. Ex. 28, p. 16; Stip. Ex. 30, pp. 7-8. That acceptance occurs while an aircraft is in Illinois, and after the customer has come into Illinois to conduct the final inspection called for by the agreement between them. Stip. Exs. 8, 11, 14, 16, 18, 20, 23, 25, 32, 35, 37 (§ 3.2 of each agreement); Stip. Ex. 28, p. 16; Stip. Ex. 30, pp. 7-8; see also 810 ILCS 5/2-606. It is only after such acceptance that "Avalon" will agree to redeliver possession of the owner's bailed plane by flying it to the owner outside Illinois. Stip. Exs. 8, 11, 14, 16, 18, 20, 23, 25, 32, 35, 37 (§ 3.2 of each agreement); Stip. Exs. 28, 30 (p. 2 ¶ 10).

A customer/bailor's subsequent decision to have "Avalon" start, takeoff and fly an aircraft from its Illinois hangar to a point outside Illinois to deliver it — as opposed to the installed goods the customer has already accepted in Illinois — back to the customer is, as "Avalon's" contracts show, a discrete service that is ancillary to the primary subject matter of its agreement with each customer. Stip. Exs. 8, 11, 14, 16, 18, 20, 23, 25, 32, 35, 37 (§§ 1.1 and 3.2 of each agreement); Stip. Exs. 28-30 (p. 2 ¶ 10 of each agreement); 86 Ill. Admin. Code § 140.501(a). Even in the agreements that did not call for "Avalon's" sales and installation of new engines, "Avalon's" agreement to perform interior work and alteration of the aircraft's avionics systems did not include its agreement to deliver the plane to the customer. Stip. Exs. 28, 30 (p. 2 ¶ 10 of each agreement). Each such service agreement expressly requires the parties to enter into another agreement for the delivery of the aircraft. *Id.* Each of those agreements, moreover, calls for an inspection at the conclusion of the work (Stip. Ex. 28, p. 16; Stip. Ex. pp. 7-8), and the documentary evidence reflects that buyer's representatives were present in Illinois during such inspections and flight tests. Stip. Ex. 46, p. 4.

Finally, since this matter involves an exemption from taxation, "Avalon" bears the burden to show that its agreement required it to deliver the *goods it transferred* incident to its sales of service from a point within Illinois to a point outside Illinois. *See* <u>Du-Mont Ventilating Co. v. Department of Revenue</u>, 73 Ill. 2d 243, 249, 383 N.E.2d 197, 201 (1978) (finding that a taxpayer satisfied its burden to prove that property used fit the exemption claimed). It has not carried its burden by introducing aircraft delivery receipts for each of the transactions that gave rise to the tax assessed here, or by

citing to the parties' stipulations regarding those delivery flights (*see* Taxpayer's Reply, pp. 6-7), because the planes are not the goods that "Avalon" transfers incident to its sales of service. Stip. Exs. 8, 11, 14, 16, 18, 20, 23, 25, 32, 35, 37 (p. 1 § 1.1 and Exhibit A of each agreement); Stip. Exs. 28-30, *passim.* Again, the legislative intent underlying the SOTA is not to tax all of the different services a serviceman might provide to a customer, but merely to tax the cost price of the goods the serviceman transfers as an incident to its provision of services. Fiorito v. Jones, 39 Ill. 2d at 536-37, 538-39, 236 N.E.2d at 702, 704. "Avalon" delivered the goods it transferred incident to its sales of service when "Avalon" made them fully functioning component parts of a customer's aircraft while the plane was in Illinois, or, at the latest, when each customer came into Illinois to inspect and accept "Avalon's" completed installation of those goods. Stip. Exs. 8, 11, 14, 16, 18, 20, 23, 25, 32, 35, 37 (§§ 1.1, 3.2 of each agreement); Stip. Ex. 28, pp. 2 (¶ 10), 16, Stip. Ex. 30 pp. 2 (¶ 10), 8-9; Stip. Ex. 46, p. 4.

"Avalon", moreover, never offered any evidence to show that its customers did not inspect and accept the goods that it installed in or on aircraft, while the aircraft was still in Illinois, in precisely the manner called for by the agreements. The agreements themselves, on the other hand, and "Avalon's" documented subsequent delivery of each of its customer's aircraft, together establish strong evidence that its buyers did accept the goods while the aircraft was still in Illinois. See Illinois Supreme Court Rule 236 (entries in business records are admissible as evidence that the act, transaction, occurrence, or event described in the entries occurred). That is to say, since "Avalon" expressly conditioned its willingness to redeliver possession of a customer's bailed aircraft by flying it to the customer outside Illinois upon the bailor/customer's prior acceptance of "Avalon's" work, and since, in each case here, "Avalon" redelivered possession of the customer's plane by flying it to the customer outside Illinois, one must reasonably infer that the customer, in fact, came into Illinois and, after inspecting the aircraft, accepted "Avalon's" work and the goods that came with it. That is, after all, what "Avalon's" agreements provided for. A taxpayer cannot rebut the statutory presumption of correctness that inures to the Department's determination that SOT is due by presenting arguments that are based on facts that are contrary to those reflected in its regularly kept books and records. See A.R. Barnes & Co., 173 Ill. App. 3d at 833-34, 527 N.E.2d at 1053. I cannot, therefore, accept "Avalon's" argument that it delivers physical possession of the goods it transfers incident to its sales of service only when it subsequently flies a customer's aircraft from its Illinois hanger to the customer.

### SOT Regulation § 130.501(c) and (d)

Subparagraph (c) of Illinois' SOT interstate commerce regulation describes the type of documentary evidence a serviceman must keep to show that certain transactions were exempt from SOT because it did not deliver physical possession of the goods it transfers to others incident to its sales of service within Illinois. 86 Ill. Admin Code § 1501.501(c). That paragraph provides:

> To establish that the selling price of property sold as an incident to any given sale of service is exempt because the property is delivered by the serviceman from a point within this State to a point outside this State under the terms of an agreement with the purchaser, the serviceman will be required to retain in his records, to support deductions taken on his tax returns, proof which satisfies the Department that there was such an agreement and a

satisfies the Department that there was such an agreement and a bona fide delivery, outside this State, of the property involved in the sale of service. The most acceptable proof of this fact will be:

1) If shipped by a common carrier: A waybill or bill of lading requiring delivery outside this State;

2) if sent by mail: An authorized receipt from the United States Post Office Department, for articles sent by registered mail, parcel post, ordinary mail or otherwise, showing the name of the addressee, the point outside Illinois to which the property is mailed and the date of such mailing; if the receipt does not comply with these requirements, other supporting does not comply with these requirements, other supporting evidence will be required;

3) if sent by the serviceman's own transportation equipment: A trip sheet signed by the person making delivery for the serviceman and showing the name, address and signature of the person to whom the goods were delivered outside this State; or, in lieu thereof, an affidavit signed by the purchaser or his representative, showing the name and address of the serviceman, the name and address of the purchaser and the time and place of such delivery outside Illinois by the serviceman, together with other supporting data as required by Section 140.701(c) of this Part and by Section 11 of the Act.

#### 86 Ill. Admin. Code § 140.501(c).

Note that, in none of the three examples given in subparagraph (c) are the goods being delivered outside Illinois via the customer's transportation equipment. The reason for that, again, is that if the customer sends its own transportation equipment into Illinois to physically take the goods from a point inside Illinois to a point outside Illinois, the customer or his representative takes delivery of physical possession of the goods in Illinois once the goods are loaded onto its transportation equipment. E.g., Pressed Steel Car Co. v. Lyons, 7 Ill. 2d 95, 129 N.E.2d 765 (1955); International-Stanley Corp. v. Department of Revenue, 40 Ill. App. 3d 397, 352 N.E.2d 272 (1st Dist. 1976); 86 Ill. Admin. Code § 140.501(a) ("The sale is not deemed to be in interstate commerce if the purchaser or his representative receives the physical possession of such property in this State. ... Except as is set out at Section 140.501(d) of this Part, it also makes no difference that the purchaser is a carrier when that happens to be the case.").

The final subparagraph of the SOT regulation, § 140.501(d), lists the exceptions to the rule that a person who takes physical possession of goods transferred incident to a sale of service is not a transaction in interstate commerce. That paragraph provides:

Effective September 17, 1982, there are two d) exceptions to the rule that the tax is applicable where the service customer receives physical possession of the

property in Illinois.

The serviceman does not incur service occupation tax liability with respect to items transferred as an incident to repairing, reconditioning or remodeling tangible personal property belonging to a common carrier by rail which takes delivery of the items in Illinois but which transports the items (or shares with another common carrier in transporting the items) out of Illinois on a standard uniform bill of lading showing the serviceman as the shipper or consignor of the items to a destination outside Illinois for use outside Illinois (Section 2 of the Act).

With respect to items produced for an interstate carrier by rail on special order (in such a way so that the applicable tax would be service occupation tax rather than retailers' occupation tax), no service occupation tax liability is incurred if that interstate carrier by rail takes delivery of the items in Illinois but transports the items (or shares with another common carrier in transporting the items) out of Illinois on a standard uniform bill of lading showing the seller as the shipper or consignor of the item to a destination outside Illinois for use outside Illinois (Section 2 of the Act).

3) The two exceptions described immediately above

at subsections (d)(1) and (2) of this Section are also applicable to local Service Occupation Tax imposed by home rule units or by the Regional Transportation Authority and the Metro East Mass

Transit District.

86 Ill. Admin. Code § 140.501(d). Both exceptions are limited to servicemen who repair, recondition or remodel tangible personal property belonging to a common carrier by rail, or to special order retailers who sell specially made goods to such carriers. Id. Since there was no evidence that any of "Avalon's" customers were common carriers by rail, neither exception is applicable to "Avalon".

### Unlike the Situations Described in SOT Regulation § 140.501(c), Each Customer Uses the Aircraft Engines or Other Goods "Avalon" Transfers Incident To Its Sales of Services, In Illinois, During Each Delivery Flight

Ordinarily, statutes and regulations are written in broad terms because they are meant to be applicable to persons performing vastly different kinds of tasks, and to be read and understood by people with varying levels of sophistication. See Pressed Steel Car Co., 7 Ill. 2d at 106, 129 N.E.2d at 771 ("[N]either the statute nor the regulations were intended to operate in an atmosphere sterilized of reality and dominated by logic alone. The statute was designed to apply to the multitudinous affairs of daily life. Its terms were general. The legislature knew that interpretation was inevitable, and it was with this knowledge that the power to make regulations was given to the Department."). Thus, when reading § 3-45 of the SOTA, and the related paragraphs of SOT regulation § 140.501, one ought not lose sight of the facts of the particular business in which "Avalon" is engaged, and the specific actions it undertakes pursuant to that business.

For example, "Avalon's" actions are not like the actions of the servicemen described in the examples listed in SOT regulation 140.501(c). First, the aircraft that "Avalon" agrees to deliver to each customer is not its own transportation equipment; it belongs to "Avalon's" customer. Second, its customer's aircraft are, in no sense of the word, being used to *transport* or *deliver* new aircraft engines, or new avionics equipment, to any customer. 35 **ILCS** 110/2 (definition of "use" in Service Use Tax Act ("SUTA")); 86 Ill. Admin. Code 140.501(b). The section of the SOT regulation that "Avalon" relies on for most of its arguments, § 140.501(b), pertains to a servicemen who is required to make physical delivery of the goods that he transfers incident to his sale of service from a point within Illinois to a point outside Illinois. *See* Taxpayer's Brief, p. 9; 86 Ill. Admin. Code § 140.501(b). Yet here, "Avalon" does not put two newly manufactured engines and the structural components required to hold those engines, or hundreds of feet of electrical wiring and assorted electronic equipment, into the passenger area of each aircraft in order to ship such property to its customers. *See* Stip. Exs. 8, 11, 14, 16, 18, 20, 23, 25, 32, 35, 37 (Exhibit A of each agreement); Stip. Exs. 28, 30, *passim*; Stip. Ex. 46, p. 4.

Rather, by the time an aircraft is ready for delivery outside Illinois, "Avalon" has already made the new engines and/or the other goods fully functioning component parts of each aircraft whose owner hired "Avalon" to perform services. In this critical way, a customer who purchases "Avalon's" services, and accepts the new engines or other goods "Avalon" installs in its aircraft, is very much like the taxpayer in <u>United Airlines v. Mahin</u>. The goods that United Airlines loaded onto its plane in Illinois, airline fuel, is the very stuff that enabled United's aircraft to start, takeoff and fly away from Illinois. Here too, the new engines and other goods that "Avalon" installs into or onto a customer's aircraft are the component parts that allow it to start, takeoff, navigate and fly away from "Avalon's" Illinois hangar. Unlike the situation in any of the examples in SOT regulation 140.501(c), the purchaser of "Avalon's" services must literally *use* the new aircraft engines or the new avionics equipment, in Illinois, simply to get its aircraft off the ground and/or to the point where the purchaser directs "Avalon" to fly it.

Also, one should not confuse who is causing the aircraft to be flown from a point inside Illinois to a point outside Illinois. "Avalon" directs pilots to fly a customer's aircraft during a delivery flight (Stip. ¶ 28), but it is directing those pilots pursuant to — and not independent of — the aircraft owner's express grant of authority for "Avalon" to do so. Stip. Exs. 8, 11, 14, 16, 18, 20, 23, 25, 32, 35, 37 (§ 3.2 of each agreement); *see also* Stip. Exs. 28, 30 (p. 2 ¶ 10 of each agreement). When a customer directs "Avalon" to fly its aircraft from Illinois to somewhere else, the customer is exercising rights and powers over its aircraft, and over all of its component parts, incident to its

ownership of those items of tangible personal property. 35 **ILCS** 110/2 (definition of "use" in the SUTA); <u>Deere & Co. v. Allphin</u>, 49 Ill. App. 3d 164, 168, 364 N.E.2d 117, 119 (3rd Dist. 1977) ("... the [SUTA's] statutory definition of 'use' refers to the exercise of the rights of ownership 'by any person' and not exclusively by the owner."). Since, by the date of delivery, the owner has already accepted the installation services and goods "Avalon" provided to it, it is exercising those powers over property — both the aircraft and the recently accepted installed goods — over which the owner already enjoys ownership and possession. <u>Deere & Co. v. Allphin</u>, 49 Ill. App. 3d at 168, 364 N.E.2d at 120 ("... physical custody of the property by the owner is not essential to a taxable use .... [An owner] can be said to have had constructive possession of its property through its agent ...."). Thus, there can be little doubt that each aircraft owner uses the goods "Avalon" installed therein for the delivery flight it directs "Avalon" to make. 35 **ILCS** 110/2; <u>Deere & Co. v. Allphin</u>, 49 Ill. App. 3d at 168, 364 N.E.2d at 119-20.

Finally, the parties do not dispute that "Avalon" is engaged in a service occupation here, and that SOT has been assessed against it. So, when I conclude that each of "Avalon's" customers used the goods "Avalon" installed into its aircraft when it directed "Avalon" to fly the aircraft back to its outside Illinois, and after it had already accepted such goods and the installation services, I am not concluding that SUT or UT, and not SOT, should be or is being assessed against "Avalon" here. Similarly, when citing to and discussing cases decided by Illinois courts that resolved disputes that arose under the ROTA, the UTA, or the SUTA, I am not suggesting that ROT, UT or SUT should be assessed against "Avalon". Rather, I use the decisions or holdings in those cases to support, by analogy, the conclusions reached here. *See, e.g.* Exhibits, Inc., 303 Ill. App. 3d at 428-31, 709 N.E.2d at 240-41 (discussing, in a case involving the assessment of SOT, cases decided under the ROTA and the UTA). I make this point only because, when the Department attempted, in its brief, to detail "Avalon's" obligations to collect SUT from its customers as a serviceman, "Avalon" replied that the Department was attempting to change the tax that was being assessed against it. Department's Brief, pp. 11-14; Taxpayer's Reply, pp. 3-7.

## The Agreement's Deferral Of Transfer Of Title To The Goods "Avalon" Installed And Transferred Incident To Its Sales Of Services

"Avalon" and each aircraft owner agreed that "Avalon" would withhold transferring title to the new engines and other goods "Avalon" installed in an aircraft until the purchaser paid it the full amount charged for its services. Stip. ¶¶ 22, 25. A seller's or serviceman's decision to defer transferring title to goods to secure payment therefor, however, cannot be used to avoid SOT or ROT, or, for that matter, to avoid UT or SUT. *See, e.g.*, Exhibits, Inc., 303 Ill. App. 3d at 429-30, 709 N.E.2d at 240-41. The Illinois General Assembly expressly provided for such common security

financing techniques, and made the seller's or serviceman's delivery, in Illinois, of the goods sold or transferred, or the purchaser's use of the goods in Illinois the determining factor for tax purposes. 35 **ILCS** 105/2 definition of "use" in the UTA); 35 **ILCS** 110/2 (definition of "use" in the SUTA); 35 **ILCS** 120/1 (a "sale at retail" includes "[t]ransactions whereby the possession of the property is transferred but the seller retains the title as security for payment of the selling price ...."). For ROT or SOT purposes, a serviceman cannot contract away its responsibility for paying taxes where all of the incidents of the sale or transfer occur in Illinois, merely by deferring the occurrence of transfer of title to the goods being sold or transferred. Exhibits, Inc., 303 Ill. App. 3d at 429-30, 709 N.E.2d at 240-41 (and cases cited therein).

### The Propriety of the 10% Penalty Assessment

For the months beginning 1/1/92 through and including 11/30/93, the Department determined that "Avalon" underpaid its monthly SOT, ROT and UT liabilities by \$1,251,694, for which it was assessed a 10% penalty in the amount of \$125,169. Department Ex. 1, pp. 1, 4 (copies of NTL's for those periods), 5, 7 (copies of corrections of returns for same periods); *see also*, Taxpayer's Brief, p. 27. Taxpayer notes that neither NTL issued regarding the periods for which penalty was assessed explain the basis for the penalty, but it argues that § 5 of the ROTA, which the SOTA incorporates by reference, applies. Taxpayer's Brief, p. 27. The Department, on the other hand, cites § 3-3(b)(1) of the Uniform Penalty and Interest Act ("UPIA") in its brief, and suggests that the penalty was assessed based on taxpayer's late payment of the amounts of tax determined to be due. Department's Brief, p. 14.

Neither taxpayer nor the Department correctly identifies the basis for the penalty. The Department is wrong that the penalty is assessed pursuant to the UPIA, because that Act became effective on January 1, 1994, after the months regarding which any penalty was assessed. P.A. 87-205, Art. 3, § 3-3 (eff. Jan. 1, 1994); Department Ex. 1, pp. 1-2, 4. And while there was a late payment penalty included on the correction of returns prepared regarding NTL no. SF19990000001, for a period when the UPIA was in effect, no late payment penalty was ever actually assessed as part of the NTL the Department issued to "Avalon". *Compare* Department Ex. 1, p. 3, *with id.*, p. 6 (correction of taxpayer's returns filed for the same period).

Taxpayer is also wrong when it suggests that the penalty is based on former § 5 of the ROTA. *See* Taxpayer's Brief, p. 28. The basis for the penalty is detailed on the corrections of taxpayer's returns, and those corrections of returns show that it was assessed pursuant to § 4 of the ROTA. *Compare, respectively* Department Ex. 1, pp. 1, 4 *with id*, pp. 5, 7.

During the months before the UPIA was in effect, § 4 of the ROTA, which was incorporated by reference into the SOTA (35 **ILCS** 115/12), provided:

\* \* \*

If the tax computed upon the basis of the [cost price of the tangible personal property transferred incident to the serviceman's sales of service] as fixed by the Department is greater than the amount of tax due under the return or returns as filed, the Department shall ... issue the taxpayer a notice of tax liability for the amount of tax claimed by the Department to be due, together with a penalty of 10% thereof; \*\*\*

\* \* \*

35 **ILCS** 120/4 (1993). Thus, the penalty was imposed based on nothing more than the Department's ministerial authority to calculate the statutory 10% penalty rate on the tax determined to be due. *See* Department of Finance v. Gandolfi, 375 Ill. 237, 240, 30 N.E.2d 737, 739 (1940) ("Our decision ... that the power to review and revise tax returns under the Retailers' Occupation Tax Act is ministerial, and not judicial, as requiring merely a calculation or computation from data upon which all minds must ordinarily reach the same result, applies with equal force to the assessment of penalties under sections 4 and 5.").

Before the enactment of the UPIA, the Department had a policy of allowing taxpayers to present evidence to support a claim that it had reasonable cause for not timely paying taxes due (*see*, *e.g.*, Private Letter Ruling 90-0740 (10/23/90)), and "Avalon" challenges the penalty assessed against it here, contending that reasonable cause exists for the Department to abate it. Taxpayer's Brief, pp. 28-31. Since the enactment of the UPIA, the Department has promulgated a regulation in which the phrase "reasonable cause" was interpreted by the Department, for the first time. 86 III. Admin. Code § 700.400. Although neither party cites to it when making arguments in this case, that regulation provides an authoritative guide to resolving whether reasonable cause exists to excuse the penalty assessed here, even though it had not been adopted when the

transactions at issue took place. Further, the regulation is considerably more lenient to taxpayer, for example, in the scope of circumstances that might constitute a taxpayer's exercise of ordinary business care and prudence, than rulings issued by the Department closer to the time of the audit period. *Compare*, *e.g.*, Private Letter Ruling 90-0740 (Oct. 23, 1990) *with* 86 Ill. Admin. Code § 700.400(e).

The UPIA's reasonable cause regulation provides that, "[t]he most important factor to be considered in making a determination to abate a penalty will be the extent to which the taxpayer made a good faith effort to determine his proper tax liability and to file and pay his proper liability in a timely fashion." 86 Ill. Admin. Code § 700.400(b). It further provides that, "A taxpayer will be considered to have made a good faith effort to determine and file and pay his proper tax liability if he exercised ordinary business care and prudence in doing so. A determination of whether a taxpayer exercised ordinary business care and prudence is dependent upon the clarity of the law or its interpretation and the taxpayer's experience, knowledge, and education. \*\*\*" 86 Ill. Admin. Code § 700.400(c).

Taxpayer challenges the penalty assessed as a percentage of the tax measured by its cost price of the 22 new engines and other goods that it installed into or onto other's aircraft, pursuant to the 13 disputed transactions. Taxpayer's Brief, p. 28 (discussing the disputed transactions). It also contests the penalty assessed as a percentage of either UT, SOT and/or ROT, which taxes it concedes it owes, and that was measured by its cost price of goods it either used, transferred or sold to others in Illinois. *Id.*, pp. 29-31 (discussing its use or transfers of goods while providing services in Illinois); Stip. ¶¶ 5-6 & n.2. I will address each in turn.

As to the penalty measured by the cost price of the goods transferred pursuant to the disputed transactions, taxpayer argues in its brief that "... the nature of the interstate commerce issue involved here and "Avalon's" arguments should make it abundantly clear that there was 'reasonable cause' for "Avalon" to report these transactions as

exempt from tax, thereby warranting abatement of these penalties." Taxpayer's Brief, p. 28. In its response, the Department argued that "... [t]axpayer was aware, from prior audits, of the position viz a viz [sic] taxation of transactions such as those at issue. In choosing to report them as exempt, it knew it would run afoul of the Department's previously indicated position." Department's Brief, p. 14. Taxpayer's reply challenges the Department's factual assertion that the transactions claimed to be in interstate commerce here had been presented in a prior audit. Taxpayer's Reply, pp. 10-11.

There is no evidence in the record to support the Department's claim that it had previously audited taxpayer regarding transactions similar to the 13 disputed transactions here. If there had been such evidence, the Department's argument would have considerable merit. After one has been notified by the tax collector that a given type of transaction is taxable, there is little credibility to the person's subsequent claim that it acted reasonably by reporting the transaction as being tax exempt. Since there is no such evidence regarding the 13 transactions at issue, however, it is necessary to consider the evidence "Avalon" cites to support its claim for penalty abatement.

In order for "Avalon" to have acted with ordinary business care and prudence when it was attempting to determine and timely pay its Illinois SOT liability regarding the disputed transactions, it must have reasonably believed that it was required, by its agreements, to deliver the goods it was hired to install into or onto other's aircraft — as opposed to the aircraft itself — to the customer outside Illinois. 86 Ill. Admin. Code § 140.501(b). Here, however, the standard agreements pursuant to which it conducted the 13 transactions at issue show that "Avalon" either expressly or impliedly required its customers to come into Illinois — after "Avalon" received the required FAA approval of its completed installation work — to inspect and then either accept or not accept its work. Stip. Exs. 8, 11, 14, 16, 18, 20, 23, 25, 32, 35, 37 (§3.2 of each agreement). It was only in the event that its customers accepted its work and the goods that came with it — while the plane was still in Illinois

— that "Avalon" would agree to redeliver possession of the customer's aircraft by flying it from Illinois to somewhere out of state. Stip. Exs. 8, 11, 14, 16, 18, 20, 23, 25, 32, 35, 37 (§3.2 of each agreement); see also Stip. Exs. 28, 30 (p. 2 ¶ 10 of each agreement). The buyer's inspection and acceptance occurred in each and every one of the transactions here. Compare id. with Stip. Exs. 9, 12, 15, 17, 19, 21, 24, 26, 29, 31, 33, 36, 38.

Moreover, because of the regulatory oversight of "Avalon's" business of making major repairs and/or alterations of aircraft, it knew that its work had to be certified as being properly completed before a customer's aircraft would be allowed to be flown anywhere. Stip. Exs. 8, 11, 14, 16, 18, 20, 23, 25, 32, 35, 37 (§3.2 of each agreement); Stip. Ex. 28, p. 16; Stip. Ex. 30, pp. 8-9; 14 C.F.R. § 43.5(a)-(b). Notwithstanding "Avalon's" arguments, what the documented facts of record make abundantly clear is that, when "Avalon" reported that its cost price of the new engines and other goods it transferred to customers by installing them into or onto a customer's aircraft in Illinois was exempt from Illinois SOT, it was ignoring its own regularly kept business records and its own highly regulated business practices. To my knowledge, no Illinois court has ever held that a person who conducts business in Illinois acts reasonably when it ignores its own regularly kept books and records, or its own business practices. Nor has "Avalon" cited to any court decision in which such a holding was made. *See* 86 Ill. Admin. Code 700.400(e)(8).

The only example of reasonable cause found in the UPIA's reasonable cause regulation that is arguably applicable to the penalty based on the disputed transactions is the one described in § 700.400(e)(9). The parties stipulated that a Department administrative law judge wrote a letter to "John Doe", dated December 1, 1993, and apparently mailed it to "Doe" c/o "Avalon's" "Sandburg" hangar. Stip. Ex. 42. The body of the letter states:

Pursuant to our telephone conversation of this month, I am writing to inform you that if you service an airplane in Illinois, arriving from an out-of-state destination, and destined for an out-of-state location, Service Occupation Tax will be incurred on the gross receipts of repairs if an owner, employee, or agent of the aircraft registrant is a passenger on the airplane when it departs Illinois subsequent to servicing.

The transportation the Taxpayer [sic] personnel derives from the airplane journey constitutes a "use" subjecting the Illinois performed services to tax.

### Stip. Ex. 42.

"Avalon", however, never once identifies the ALJ's letter as evidence that shows that it had reasonable cause to believe that it was not required to report and pay SOT on the disputed transactions. Instead, it cites to the letter to argue that the Department changed its position when it assessed SOT against "Avalon" for the transactions here. *See* Taxpayer's Brief, pp. 17-19. Thus, "Avalon" has not even argued that it relied on the ALJ's letter to its detriment. 86 Ill. Admin. Code § 700.400(e)(9)(C), (E).

"Avalon" also critically mischaracterizes the letter by arguing that it purports to notify it that SOT would apply "... only if ..." an owner, or its employee or agent were a passenger on the plane when it left Illinois during a delivery flight. *Compare* Taxpayer's Brief, p. 17 with Stip. Ex. 43. If the letter so stated, that might certainly constitute erroneous information. *See* 86 Ill. Admin. Code § 700.400(e)(9) (reasonable cause may be shown where the information is, in fact, erroneous). That is, if the letter really did include the phrase "... only if ..." where the word "if" is used, then a reader might conclude that no SOT would be due on "Avalon's" transactions, even if the owner or the owner's agent were not the passenger, but the pilot of the aircraft when it left Illinois.

But the letter does not state that SOT will be imposed on a given transaction *only if* the purchaser or its agent is a passenger on the aircraft. Stip. Ex. 43. In fact, depending on the question that was asked, the letter may well convey information that is perfectly accurate. For example, if the questioner asked, "Will a serviceman be subject to SOT if, after installing goods into or onto a customer's plane in Illinois, the customer comes into Illinois and accepts the goods and services, and is then a passenger on the flight whereby the serviceman redelivers possession of the bailed aircraft to the customer to a point outside Illinois?", then the ALJ's answer "yes" (I paraphrase here) is perfectly correct. Since, however, this record is absolutely devoid of any evidence regarding what question the ALJ was responding to, there is not even enough evidence to know whether the information contained in the ALJ's letter is erroneous. 86 Ill. Admin. Code § 700.400(e)(9).

"Avalon" further mischaracterizes the letter as a private letter ruling. Taxpayer's Brief, p. 17. A private letter ruling, however, is defined by regulation (2 Ill. Admin. Code § 1200.110), and there are certain requirements that must be met before a private letter ruling will be issued. Those requirements are described in 2 Ill. Admin. Code § 1200.110(a)(3)(b), and they include that a taxpayer must put its request in writing, together with "[a] complete statement of the facts and other information pertinent to the request ... [including] [t]he material facts [,] ... the identification of all interested parties, a statement of the business reasons for the transaction, ... a detailed description of the transaction ... an analysis of the relation of the material facts to the issues ... [and copies of] ... [a]ll contracts, licenses, agreements, instruments or other documents relevant to the request. 2 Ill. Admin. Code § 1200.110(a) (3)(b)(1)-(2), (8) (regulation § 1200.110(b)(8) requires the taxpayer's signature to be affixed to its request for a private letter ruling, thereby requiring that the request for the private letter ruling be in writing). Here, however, the text of the letter itself shows that it was written in response to a telephone call, and not in response to a writing in which "Avalon" fully disclosed the facts underlying its request. Stip. Ex. 43.

Finally, the Department is correct when it asserts that an ALJ does not typically issue written advice to taxpayers. Department's Brief, p. 13. But even more pointedly, such a practice is expressly prohibited by the Department's regulations. 86 Ill. Admin. Code § 200.115 (prohibiting ex parte communications). Rather, an ALJ is authorized to conduct hearings, issue oaths and write recommendations regarding contested cases pending before the Department's office of administrative hearings. 86 Ill. Admin. Code § 200.105 (definition of an administrative law judge). There is simply no evidence presented by this record to show why "Doe", presumably acting on "Avalon's" behalf, telephoned an ALJ to seek advice on a substantive issue of law, just as there is absolutely no evidence why or under what specific circumstances the ALJ undertook to write and mail the letter that is part of this record. The letter admitted in this matter, appears clearly to have been written by someone who lacked the authority to issue advice to the public. 86 Ill. Admin. Code §§ 200.105, 200.115, 700.400(e)(9)(D). "Avalon", moreover, did not introduce any evidence to show why it believed the ALJ was a person from whom it could properly seek advice on a substantive issue of law. See 86 Ill. Admin. Code § 700.400(e)(9)(E).

While at first blush, UPIA regulation § 700.400(e)(9) appears to apply to this matter, there was no competent evidence offered at hearing to show that the ALJ's letter conveys erroneous information. Based on the evidence that was adduced at hearing, I conclude that taxpayer has not supported its claim that it acted with ordinary business care and prudence when it reported that its cost price of the new engines and other goods it transferred as part of the transactions in dispute were exempt from SOT.

As to that part of the penalty measured by a percentage of the uncontested tax assessed against "Avalon", the record includes documentary evidence to show that "Avalon" had previously been assessed either UT, SOT or ROT regarding the same types of transactions for which tax was assessed here. That evidence is included within the auditor's comments and workpapers, which were admitted either by stipulation, or without objection by taxpayer. Department Ex. 2, pp. 4-5 (describing prior audit figures being used to determine exception projections of taxable uses, sales or transfers of goods in amounts less than \$50,000, for purposes of UT, ROT and SOT); Stip. Ex. 44 (audit workpapers for monthly periods beginning 1/1/92 through 4/30/93), unnumbered pp. 6-8 (on auditor-prepared schedule titled, "Global taxable exceptions", under "Reason Questioned" column, entries stated, "Block Average From Prev Audit"), 25 (schedule titled, "Totals for Sales Projection[,] Misc. Retail Sales", uses percentage of error from previous audit when determining net

sales for projection purposes), 38 (schedule titled, "Totals for Sales Projection[,] Service Repair – Mtls. Transferred", uses percentage of error from previous audit when determining net sales for projection purposes); Stip. Ex. 45 (audit workpapers for monthly periods beginning 5/1/93 through 12/31/94), unnumbered pp. 4-5, 7-8 (on auditor-prepared schedule titled, "Global Taxable Exceptions", under "Reason Questioned" column, entries stated, "Block Average From Prev Audit" or "Error Percent From Prev Audit), 40 (schedule titled, "Totals for Sales Projection[,] Service Repair – Mtls. Transferred", uses percentage of error from previous audit when determining net sales for projection purposes).

Nevertheless, taxpayer argues that, since the uncontested tax assessed was assessed on a small percentage of "Avalon's" total transactions, its underreporting of those taxable transactions must be viewed as "... the inevitable occurrence of a small number of unintentional errors over the course of a multi-year audit period." Taxpayer's Brief, p. 29. It argues further that, "[t]he Department's attempt to collect penalties under these circumstances is effectively requiring near-perfect compliance from taxpayers, and that cannot be the appropriate or a reasonable standard." *Id.*, p. 30. In other words, "Avalon" argues that where a busy taxpayer has previously been assessed tax, during a prior audit, for the same types of transactions for which it is again assessed tax, the Department ought not be able to assess a penalty the second time around because it cannot reasonably expect the taxpayer to fully comply with its reporting and payment obligations under Illinois' tax laws. Not surprisingly, taxpayer includes no citation of authority to support this novel argument. *See* Taxpayer's Brief, pp. 29-30.

A servicemen may either pay SOT to its suppliers when its acquires goods purchased for subsequent transfer to others incident to its occupation of making sales of service, or it may self-report its cost price of such goods when it makes a transfer incident its sales of service. 35 **ILCS** 115/3-40, 5, 9. Since the serviceman has the ability to defer satisfying its tax liability until the time it makes a taxable transfer, the Illinois legislature also imposed a system of civil penalties to help ensure that the SOTA's timely self-reporting provision, § 9, is complied with. 35 **ILCS** 115/9, 12 (incorporating the penalties imposed by the ROTA and the UPIA). In this respect, taxpayer's argument that, "... penalty assessments are punitive actions intended for those taxpayers that engage in consistent patterns of noncompliance" (see Taxpayer's Brief, p. 30) is simply not true. Rather, the Illinois appellate court recently held that the ROTA's penalty provisions, even the one that imposes a penalty for fraud, do not constitute punishment, but "... are remedial and are reasonably related to compensating the government, in the form of liquidated damages, for its tax collection and enforcement activities." People v. Kim, 284 Ill. App. 3d 637, 642, 672 N.E.2d 1305, 1308 (2nd Dist. 1996).

And while the undisputed amounts of tax appear to have been premised on a comparatively small percentage of "Avalon's" total purchases or sales (*see* Taxpayer's Brief, p. 29 (citing Stip. Exs. 44-45)), "Avalon's" failure to report those transactions as being taxable gave rise to a considerable tax deficiency. Department Ex. 1, pp. 1, 4; Taxpayer's Brief, p. 27. Had it reported those transactions as being taxable, which it concedes they were, "Avalon" would have previously paid either UT, SOT or ROT in the amount of over \$369,000 over the course of less than two years. Taxpayer's Brief, p. 27. That deficiency was only discovered because of the Department's audit — an audit that was conducted after a prior audit during which the same type of transactions were determined to be taxable. Department Ex. 2, pp. 4-5; Stip. Ex. 44, unnumbered pp. 6-8, 25, 38; Stip. Ex. 45, unnumbered pp. 4-5, 7-8, 40.

As for the uncontested amounts of different tax assessed, I cannot recommend that the Director accept "Avalon's" first argument, that it is virtually impossible for it to have fully complied with its tax reporting and paying obligations. Nor does the record support taxpayer's second argument, that it reasonably believed certain transactions were not taxable, where the record clearly shows that "Avalon" was previously audited and assessed tax regarding the same type of transactions. Department Ex. 2, pp. 4-7; Stip. Ex. 44, unnumbered pp. 6-8, 25, 38; Stip. Ex. 45, unnumbered pp. 4-5, 7-8, 40. Based on this record, I conclude that "Avalon" has not established that it acted with ordinary business care and prudence when it failed to include either the gross receipts or the cost price of such goods either used, sold or transferred as being taxable on its monthly returns during the audit period.

### "Avalon's" Constitutional Objections to the SOT Assessed

The cases cited by "Avalon" to support its claim that the assessment of SOT against it would violate the United States Constitution' Commerce Clause were decided based on the dormant, or negative aspect of the Commerce Clause. *E.g.*, Taxpayer's Brief, pp. 21 (*citing* Complete Auto Transit v. Brady, 430 U.S. 274 (1974)), 22 (*citing* Mobil Oil Corp. v. Commissioner, 445 U.S. 425 (1980); Armco, Inc. v. Hardesty, 467 U.S. 638 (1984); Gwin, White & Price, Inc. v. Heneford, 305 U.S. 434 (1939)); *see also* Town Crier, Inc. v. Department of Revenue, 315 Ill. App. 3d 286, 291-92, 733 N.E.2d 780, 784-85 (1<sup>st</sup> Dist. 2000). The "dormant Commerce Clause" refers to the longstanding majority holding of the United States Supreme Court, that the constitution's grant of

power to Congress to regulate interstate commerce (U.S. Const. art. I, § 8, cl. 3) carries with it a negative command that, even without any action by Congress, precludes the states from passing laws that discriminate against interstate commerce. Town Crier, Inc., 315 Ill. App. 3d at 291, 733 N.E.2d at 784.

Taxpayer's constitutional arguments fail to serve its ends in this case, however, because pursuant to its power to regulate commerce, Congress has specifically articulated, in Title 49 of the United States Code, which types of state taxes on aviation are prohibited, which types of taxes unreasonably burden and discriminate against interstate commerce, and which types of taxes a state may impose on aviation. 49 U.S.C. § 40116 (State Taxation). Since Congress has affirmatively spoken on the issue at hand, "Avalon's" resort to a dormant Commerce Clause analysis is unnecessary.

Specifically, § 40116 of the Transportation Code provides:

§ 40116. State taxation

Definition. - In this section, "State" includes the District of Columbia, a territory or possession of the United States, and a political authority of at least 2 States.

**Prohibitions**. - Except as provided in subsection (c) of this (b) section and section 40117 of this title, a State, a political subdivision of a State, and any person that has purchased or leased an airport under section 47134 of this title may not levy or collect a tax, fee, head charge, or other charge on -

an individual traveling in air commerce;

the transportation of an individual traveling in air (2) commerce;

the sale of air transportation; or (3)

the gross receipts from that air commerce or **(4)** transportation.

Aircraft Taking Off or Landing in State. - A State or political subdivision of a State may levy or collect a tax on or related to a flight of a commercial aircraft or an activity or service on the aircraft only if the aircraft takes off or lands in the State or political subdivision as part of the flight.
(d) Unreasonable Burdens and Discrimination Against

**Interstate Commerce.** -

(1) In this subsection -

'air carrier transportation property' means property (as defined by the Secretary of Transportation) that an air carrier providing air transportation owns or uses.
(B) "assessment" means valuation for a property tax levied

by a taxing district.

'assessment jurisdiction'' means a geographical area in a State used in determining the assessed value of property for ad valorem taxation.

- (D) "commercial and industrial property" means property (except transportation property and land used primarily for agriculture or timber growing) devoted to a commercial or industrial use and subject to a property tax levy.
- (A) A State, political subdivision of a State, or authority acting for a State or political subdivision may not do any of the following acts because those acts unreasonably burden and discriminate against interstate commerce:
  - (i) assess air carrier transportation property at a value that has a higher ratio to the true market value of the property than the ratio that the assessed value of other commercial and industrial property of the same type in the same assessment jurisdiction has to the true market value of the other commercial and industrial property.

(ii) levy or collect a tax on an assessment that may not be made under clause (i) of this subparagraph.

- (iii) levy or collect an ad valorem property tax on air carrier transportation property at a tax rate greater than the tax rate applicable to commercial and industrial property in the same assessment jurisdiction.
- (iv) levy or collect a tax, fee, or charge, first taking effect after August 23, 1994, exclusively upon any business located at a commercial service airport or operating as a permittee of such an airport other than a tax, fee, or charge wholly utilized for airport or aeronautical purposes.

(B) Subparagraph (A) of this paragraph does not apply to an in lieu tax completely used for airport and aeronautical purposes.

aeronauticai purposes.

(e) Other Allowable Taxes and Charges. - Except as provided in subsection (d) of this section, a State or political subdivision of a State may levy or collect -

- (1) taxes (except those taxes enumerated in subsection (b) of this section), including property taxes, net income taxes, franchise taxes, and sales or use taxes on the sale of goods or services; and
- (2) reasonable rental charges, landing fees, and other service charges from aircraft operators for using airport facilities of an airport owned or operated by that State or subdivision.

49 U.S.C. § 40116 (emphasis added).

Here, the SOT assessed against "Avalon" clearly does not constitute an act that is prohibited by either § 40116(b) or (d)(A). The tax, moreover, is a sales tax substitute (*see* Fiorito v. Jones, *supra*), which, under the circumstances of this case, is measured by a serviceman's cost price of the goods it installed into or onto a customer's airplane in Illinois, where the customer both flew its noncommercial plane into Illinois to purchase the serviceman's goods and services, and where, after inspecting the serviceman's

completed work in Illinois, the customer accepted that work and then directed that the plane take off and be flown out of Illinois. *See* 49 U.S.C. § 40116(c), (e)(1). The tax here, moreover, is not being assessed on commercial aviation at all, but on "Avalon's" cost price of goods that it transferred into or onto privately owned business aircraft. Stip. ¶ 3. Thus, not only is the tax assessed here not one of the acts that Congress either prohibited or declared to "... unreasonably burden and discriminate against interstate commerce" (49 U.S.C. § 40116(b), (d)(A)), but it is a tax that Congress expressly allowed a state to assess. 49 U.S.C. § 40116(e)(1).

And if 49 U.S.C. § 40116 does not constitute Congress' plain and clear statement that a tax allowed under § 40116(e)(1), such as Illinois' SOT, does not unreasonably burden or discriminate against interstate commerce, then Illinois' taxation of "Avalon's" occupation, conducted within Illinois' borders, also clearly satisfies the test articulated in Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 97 S.Ct. 1076, 51 L.Ed.2d 326 (1977). The United States Supreme Court's decision in Complete Auto Transit held that a state tax will withstand a Commerce Clause challenge where the practical effect of the tax:

- 1. is applied to an activity that has substantial nexus with the taxing state;
- 2. is fairly apportioned to activities carried on by the taxpayer within the state;
- 3. does not discriminate against interstate commerce;
- 4. is fairly related to services provided by the state.

### Complete Auto Transit, 430 U.S. at 279, 97 S.Ct. at 1079.

Since "Avalon" challenges only the third of the four factors (Taxpayer's Brief, p. 21), this recommendation will discuss only whether the SOTA discriminates against interstate commerce. <u>Town Crier, Inc.</u>, 315 Ill. App. 3d at 291, 733 N.E.2d at 784. "Avalon" argues that the SOTA discriminates against interstate commerce because it

creates both the risk and the reality of multiple taxation, and because the Act imposes practical and punitive burdens on interstate commerce that intrastate commerce does not suffer. Taxpayer's Brief, p. 21. All of taxpayer's arguments that the SOTA imposes practical and punitive burdens to interstate commerce are based on its allegation that SOT was assessed against it only once its customers flew aircraft into Illinois which "Avalon" had previously modified or serviced. Taxpayer's Brief, pp. 23-26. The Department has unequivocally stated, however, that the customer's return of an aircraft into Illinois does not form any of the bases upon which SOT is assessed. Department's Brief, p. 5. Rather than discussing a hypothetical situation, therefore, I will confine the recommendation's analysis of taxpayer's second argument to the facts of this case. I begin, however, with "Avalon's" assertion that the SOTA causes the risk or reality of multistate taxation.

The parties stipulate that "Avalon" paid tax on three of the thirteen transactions at issue to states other than Illinois. Stip. ¶¶ 14a, 16a, 19a; Stip. Exs. 22, 27, 33. In its brief, "Avalon" cites to these facts and evidence to argue that if SOT is assessed against it here, the SOTA must be understood as constitutionally invalid, because that Act will have subjected "Avalon" to actual multiple taxation for those three transactions. Taxpayer's Brief, p. 21. When making this argument, however, it ignores the auditor's hearing testimony to the effect that, had taxpayer presented him with proof that it paid tax to other states on those three transactions, and where the transaction was taxable in those states, he would have given "Avalon" a credit or offset against the amount of Illinois SOT assessed for those three transactions. Tr. pp. 23-25, 28-29 (testimony of "William Westmoreland").

Taxpayer disputes that such a credit is allowed under the SOTA (Taxpayer's Brief, p. 24 ("... the [SOT] Act provides no such relief.")), and it belittles the Department's argument that Illinois law provides for a credit for tax properly due and paid to another state, for a transaction on which SOT is also assessed. Taxpayer's Reply, p. 9. Specifically, "Avalon's" reply states, "The Department boldly asserts (Dept. Br. at 10) that Illinois does provide a credit for sales taxes properly levied by other states on the same property, yet, disingenuously gives Section 3-45 of the SOT[A] as authority for that proposition, and of course, no such credit can be found in that Section." Taxpayer's Reply, p. 9. I do not believe the Department is being less than straightforward when it cites SOTA § 3-45; rather, it is simply mistaken when citing the authority for its proposition. See American Heritage Dictionary 248 (3d office ed. 1994). The authority is not the text of the SOTA itself, but is found in the Illinois appellate court's interpretation of the Act and its complement, the SUTA. Allemed, Inc. v. Department of Revenue, 101 III. App. 3d 746, 752-53, 428 N.E.2d 714, 719-20 (4<sup>th</sup> Dist. 1981) (applying the Illinois supreme court's holding and rationale in Philco Corp. v. Department of Revenue, 40 Ill. 2d 312, 239 N.E.2d 805 (1968) to a case brought pursuant to the SOTA).

Here, there is no dispute that "Avalon" paid sales tax to either Massachusetts or Indiana for three of the 13 transactions at issue, and that such tax was properly assessed by those states. Stip. ¶¶ 14a, 16a, 19a. Additionally, had "Avalon" presented proof of its

While it now chides the Department for suggesting that a credit against SOT is authorized by Illinois law (*see* Taxpayer's Reply, p. 9), in both of its protests, "Avalon" asked that it be allowed a credit for the tax it paid to other states regarding the same transactions for which it was assessed SOT. Stip. Ex. 6. p. 5; Stip. Ex. 7, p. 4.

payments of tax properly assessed by other states to the Illinois auditor who prepared the Department's corrections of "Avalon's" Illinois monthly returns in this case, the record is clear that he would have credited or offset "Avalon's" Illinois SOT liability for the goods it transferred pursuant to those three transactions. Tr. pp. 23-25, 28-29 ("Westmoreland").

Finally, the base of the tax assessed by the states other than Illinois was, like Illinois, the cost price of the materials "Avalon" installed into or onto a customer's aircraft, pursuant to each transaction. Stip. ¶¶ 14a, 16a, 19a; Stip. Exs. 22, 27, 33. The tax assessed by the other states, however, was 5% of the material cost (Stip. Exs. 22, 27, 33), whereas Illinois SOT is assessed at the rate of 6.25% of the same cost. 35 ILCS 115/3-10. Since the credit is available, "... to the extent ..." of the tax properly due and paid to other states (35 ILCS 110/3-45; Allemed, Inc., 101 Ill. App. 3d at 752-53, 428 N.E.2d at 719-20), "Avalon" would still be required to pay the remaining 1.25% of its cost price of the goods it delivered to its customers in Illinois by installing such goods into or onto aircraft in Illinois, incident to those three transactions. Based on those undisputed facts, and pursuant to the holding in Allemed, I agree with the Department that Illinois law provides that "Avalon" be granted a credit against the SOT assessed for the amount of tax properly due and paid to Massachusetts and Indiana, for the three transactions. Allemed, Inc., 101 Ill. App. 3d at 752-53, 428 N.E.2d at 719-20. And while I note that a state's provision of a credit is not always constitutionally required under the Commerce Clause (Quill Corp. v. North Dakota, 504 U.S. 298, 305, 112 S.Ct. 1904, 1909, 119 L.Ed.2d 91 (1992) ("Congress has plenary power to regulate commerce among the States and thus may authorize state actions that burden interstate commerce ....")),

Disingenuous means not straightforward or candid; crafty. American Heritage Dictionary 248 (3d office ed. 1994).

since Illinois law clearly does allow a credit to be given under the circumstances stipulated here, I reject "Avalon's" argument that the SOTA discriminates against interstate commerce by requiring actual multiple taxation, or the risk thereof.

Nor do I agree with "Avalon's" argument that the SOTA discriminates against interstate commerce by imposing practical and punitive burdens on interstate commerce that intrastate commerce does not suffer. Taxpayer's Brief, p. 21. For example, the decision in Allemed shows that Illinois' credit is applicable to servicemen and/or suppliers who are primarily based outside Illinois, just as it is applicable to Illinois based serviceman, such as "Avalon". Allemed, Inc., 101 Ill. App. 3d at 752-53, 428 N.E.2d at 719-20. The SOT rate is also the same for Illinois-based servicemen and for servicemen based outside Illinois. 35 ILCS 110/7, 13-14 (all dealing with foreign servicemen); 35 ILCS 115/3-10; Exhibits, Inc., 303 Ill. App. 3d at 429, 709 N.E.2d 236, 240 (1st Dist. 1998); Allemed, Inc., 101 Ill. App. 3d at 752-53, 428 N.E.2d at 719-20.

And when it comes to persons who sell or service goods that are intended to be used as component parts of a commercial enterprise's rolling stock, Illinois taxes transactions involving the sale, transfer or purchase and use of goods, in Illinois, to or by intrastate carriers for hire, or to or by private carriers. Admiral Disposal Co. v. Department of Revenue, 302 Ill. App. 3d 256, 259-60, 706 N.E.2d 118, 120-21 (2<sup>nd</sup> Dist. 1999); Square D Co. v. Johnson, 233 Ill. App. 3d 1070, 1081-83, 599 N.E.2d 1235, 1242-43 (1<sup>st</sup> Dist. 1992) (articulating differences between carriers for hire and private carriers). On the other hand, Illinois law exempts from taxation the gross receipts or cost price of goods sold, transferred or purchased and used and intended to become component parts of the rolling stock of interstate carriers for hire. 35 ILCS 105/3-60; 35 ILCS 110/3-50;

35 **ILCS** 115/2(d), (d-1), (d-2); 35 **ILCS** 120/2-50. Thus, contrary to taxpayer's argument, and as the SOTA is applied to transactions whereby goods are transferred by a serviceman for use as component parts of rolling stock, Illinois tax law clearly treats interstate commerce *better* than it does intrastate commerce. I conclude, therefore, that "Avalon" has not borne its heavy burden of establishing that Illinois' assessment of SOT here, or that the SOTA itself, is unconstitutional.

### Conclusion

Based on the evidence adduced at hearing, I conclude that "Avalon" delivers physical possession of the new engines and other goods it installs into or onto its customer's airplanes in Illinois. It delivers physical possession of the goods, at the earliest, when it obtains FAA certification and approval of its installation and alteration work, and thereby, when "Avalon" has made such goods fully-functioning component parts of those aircraft. Stip. Exs. 8, 11, 14, 16, 18, 20, 23, 25, 32, 35, 37 (§ 3.2 of each agreement); Stip. Ex. 28, p. 16; Stip. Ex. 30, pp. 7-8; 14 C.F.R. §§ 43.5, 43.7, 43.9. At the latest, "Avalon" delivers physical possession of the goods it transfers to customers when, pursuant to its contracts, a customer comes into Illinois to inspect and accept "Avalon's" work and the goods that were installed into or onto the customer's aircraft, as part of that work. Stip. Exs. 8, 11, 14, 16, 18, 20, 23, 25, 32, 35, 37 (§ 3.2 of each agreement); Stip. Ex. 28, pp. 2 (¶ 10), 16; Stip. Ex. 30, pp. 2 (¶ 10), 7-8.

In each transaction at issue, the FAA certifications and the customer inspections and/or acceptances occurred while its customer's aircraft were physically located within Illinois. Stip. Exs. 8, 11, 14, 16, 18, 20, 23, 25, 32, 35, 37 (§ 3.2 of each agreement); Stip. Ex. 28, pp. 2 (¶ 10), 16; Stip. Ex. 30, pp. 2 (¶ 10), 7-8; Stip. Ex. 46, p. 4. The FAA

approvals and certifications, and the customer's acceptance of its work, moreover, must have occurred before "Avalon" would agree to redeliver possession of its customer's bailed aircraft by flying it to the customer from "Avalon's" Illinois hangar to a point outside Illinois. Stip. Exs. 8, 11, 14, 16, 18, 20, 23, 25, 32, 35, 37 (§ 3.2 of each agreement); Stip. Ex. 28, pp. 2 (¶ 10), 16; Stip. Ex. 30, pp. 2 (¶ 10), 7-8; Stip. Ex. 46, p. 4. Since "Avalon" delivered physical possession of the goods it installed into or onto its customer's aircraft to the customer in Illinois, "Avalon's" cost price of those goods are subject to SOT. International-Stanley Corp., 40 Ill. App. 3d at 407, 352 N.E.2d at 280; 86 Ill. Admin. Code § 140.501(a).

I conclude that "Avalon" is entitled to a credit in the amount of \$325,750 for the aggregate amount of tax properly due and paid to the states of Massachusetts and Indiana, for three of the transactions for which SOT was also assessed here. Stip. ¶¶ 14a, 16a, 19a; Stip. Exs. 22, 27, 34 (107,500 + 105,000 + 113,250 = 325,750); Allemed, Inc., 101 Ill. App. 3d at 752-53, 428 N.E.2d at 719-20. I further conclude that "Avalon" has not borne its burden to show that the 10% penalty, assessed pursuant to § 4 of the ROTA, and incorporated by the SOTA, should be abated here. Finally, I conclude that "Avalon" has not shown that the SOTA violates the United States Constitution's Commerce Clause, because it discriminates against interstate commerce.

I recommend, therefore, that the Director revise the NTL's issued here to reflect a credit in the amount of \$325,750 against the amount of Illinois SOT due, and that he finalize those NTL's as so revised, with interest to accrue pursuant to statute.

Date: 1/16/2002 John E. White

## Administrative Law Judge